SLUMP AND RECOVERY
1929–1937

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A SURVEY OF WORLD ECONOMIC AFFAIRS

By

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PREFACE

THIS book is founded on the chapters which the author contributed to seven successive volumes of the annual *Survey of International Affairs* that is published under the auspices of Chatham House. The writer of this preface, being responsible for the production of the *Survey*, was, of course, aware, year by year, of the value of contributions without which the *Survey* would not have deserved its title. The economic element in international affairs goes to the heart of them; and no attempt to survey them would be comprehensive, or indeed intelligible, if it did not take due account of their economic aspect. Yet though the annual *Surveys* for the years 1930 to 1936 inclusive would not have been complete without Mr. Hodson's chapters, the present book, based on these, can stand by itself, because, on the economic plane, the international history of those years constitutes a distinct chapter, with a clearly marked beginning and end—in contrast to the corresponding events on the political plane, which have lagged behind their economic counterparts, as is pointed out by Mr. Hodson in a suggestive passage at the close of the present work.

This work does not attempt to give an exhaustive account of the international transactions of an economic character in the period with which the book is concerned, and at the same time it does not confine its attention to matters that are international in the strict sense, to the exclusion of the domestic economic affairs of the states which, in these years, were 'key countries' from the economic standpoint. In this, Mr. Hodson is following the practice of the *Survey*, which deals with municipal affairs in so far as some account of these may seem necessary, in particular cases, for making the general course of international affairs clear. This practice, which is suggested by common sense, is perhaps even less in need of defence in the economic field than in the political; for the division between 'international' and 'municipal' affairs, which is arbitrary even on the political plane, is apt to break down completely in any history that is written from the economic

angle of vision. On the economic plane, the World's affairs remain united, notwithstanding Man's almost superhuman efforts to put them asunder; and this truth is illustrated in the present volume by Mr. Hodson's very practical way of handling his subject.

The reader will find here, within manageable compass, the information which the title of the book would lead him to expect; and he will also find this set out in a form which reveals the intricate relations between the diverse threads of the economic weft, as well as the interaction, on the international scale, between economics and politics.

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14th June 1938.

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THE BACKGROUND, 1920–9

(a) *Introductory*

THIS book does not seek to give a complete economic history of the period that it covers. It is a history only of international affairs in the economic sphere, and it ventures upon the story of developments within any national unit only when that story is necessary to an understanding of the international theme. In particular, only very brief references are made to the internal economic events and changes of the United Kingdom; for it is assumed that the average reader is familiar with them and has many other sources of information for their study.

The book is based on the economic chapters in the annual *Survey of International Affairs* from 1930 to 1936. The period of the author's contributions to the *Survey* happened to be a peculiarly self-contained one in economic history. It began with the collapse of the second post-War boom, and ended with the price inflation which may prove to have marked the peak of the next boom, though this only time can tell. Since, however, economic affairs are even more continuous than political affairs, it is necessary to go back some way farther into the past, and to seek the causes of the world depression in the major trends of international economic history since the world war.

(b) *Economic Nationalism*

One of the most striking of post-War tendencies was the growing interference of the political organization with economic affairs. Economic nationalism was itself no new thing. The prevailing *laissez-faire* of the mid-nineteenth century did not last until 1914. The economic nationalism of Germany from the nineties onward aroused European jealousies and evoked reprisals. The Third Republic renounced the Cobdenism of the Second Empire. Among the new countries, the United States, Canada, and Australia all set foot on the path

of industrial protection long before the end of the nineteenth century. Economic nationalism stood out so prominently in the post-War world because it was accompanied by exceptional professions and even some performance of internationalism, political and economic; because its scope was increased by the repartition of Europe; and because it took new and more insidious forms.

Economic nationalism was a conspicuous feature of the policy of the new European countries. The successor-states of Austria-Hungary celebrated their separate sovereignty by imposing high tariffs, partly because the new political boundaries were often economically unnatural. The Baltic was girded with tariff walls, Poland's being perhaps the highest in the world. The Irish Free State proclaimed her fiscal independence in the same fashion. Meanwhile the countries of the New World—the United States, Canada, Australia, certain of the larger states of Latin America—were pursuing farther their industrial protectionism. In India, economic nationalism was in large measure incidental to political nationalism, as it was in China. Great Britain herself had grown restive under free trade, and by the end of the first post-War decade she already possessed a string of protective duties, some of them of considerable importance.

The table opposite was constructed for the World Economic Conference of 1927.

According to one experienced observer, writing in 1930, 'the strongly protective policy of many nations remains, but in fact it does not appear to affect the total of trade much more heavily than pre-War tariffs; it is, rather, limited to a small number of acutely self-conscious countries and to particular goods which they hope to manufacture'.[1] This judgement referred apparently to the situation in the middle of the decade, and certainly not to the increases of protection that marked the onset of the world depression.

Like pre-War tariffs, the tariffs of the post-War world were imposed for two connected reasons. The first was industrial, namely, to secure the home market for certain industries and

[1] A. L. Bowley, *Some Economic Consequences of the Great War* (London, 1930, Home University Library), p. 198.

(so it was hoped) to augment the volume of employment that might be afforded at an accepted wage-level. The pressure of this motive was increased by the dislocation of industry during and immediately after the War, and by the difficulties that occurred in the field of currency and exchange.

*Tariff-Level Indices**

	1913	*1925*
Austria	18	16
Czechoslovakia	18	29
Hungary	18	27
Italy	18	22
Germany	13	20
France	20	21
United Kingdom	0	5
United States of America	44†	37
Belgium	9	15
Holland	4	6
Denmark	14	10
Sweden	20	16
Switzerland	9	14
Poland	?	32
Jugoslavia	?	23

* 'The expression tariff level or height of tariff, as a generic term, is taken to mean a magnitude which is equal to the average of the percentages which the duties imposed by any given country constitute of the values of the commodities which go to compose the whole catena of goods normally entering into international trade.' 'The figures must be accepted with great reservation and do not pretend to be anything more than the roughest approximation.' League of Nations, II, 1927, ii. 34.

† In 1914 only 25.

The second reason for the imposition of tariffs was strategic, namely, to foster industries held to be specially valuable in time of war. Attempts by European countries to attain self-sufficiency in primary foodstuffs and materials continued as before, but new industries were joining old ones in politico-military favour. For example, the Dyestuffs Regulation Act in Great Britain, which had its counterparts elsewhere (principally in Japan), was aimed not merely at tempering the wind to a new lamb but also at fostering what some held to be the key industry in future wars.

The field of international trade had also been invaded by an entirely new political force. Russia, however shocking her

past or precarious her future, had attempted a great experiment in organized economic life. Here it is necessary only to fit the Russian experiment into the picture of post-War economic nationalism. Because the economic life of the U.S.S.R. was regarded as a whole, having as its single purpose the advancement of a preconceived campaign of economic progress, Russian trade and industry cannot be discussed with the same theoretical technique as private trade and industry. 'A plan regulating the country's exports and imports is drawn up at the beginning of each new business year; and no important import or export operation can be carried out without the knowledge and approval of the Trade Commissioner.'[1] Dumping, in the sense of sale abroad below cost of production, as well as below the price obtainable in the home market, was almost inevitable under the Communist system, for the trade-balance could not be left to look after itself.[2] Certain things must be bought, and an equivalent quantum of things must therefore be sold. If enough could not be sold at cost price, some products must be sold below cost price. Thus Russian dumping was different in character from dumping as practised in Western countries. The latter only occurred where it was to the advantage of the dumping industry itself; the former where it was conceived to be to the advantage of the dumping country as a whole. Communism, for all its internationalist professions and aspirations, manifested itself, by force of circumstances, as a nationalistic force. Its moral principle was reconcilable with the widest internationalism, but its economic principle of state-owned and state-managed industry as a whole required a national unit for its performance.

Thus an observer at the beginning of the period with which this book is concerned looked out on a world of states jealously preserving their several economic fancies, striving for exports and suspicious of imports. Self-sufficiency rather than specia-

1 W. H. Chamberlain, *Soviet Russia* (London, 1930, Duckworth), p. 354.

2 'It is probable that, with the important exceptions of oil and matches, almost all Soviet exports of industrial goods, like the exportation of food products, could be sold on the internal market at a price higher than the nominal price obtained on the international market.' Calvin B. Hoover, *The Economic Life of Soviet Russia* (London, 1931, Macmillan), p. 1162.

lization was the prevailing aim. Tariffs, bounties, quotas, licences, import boards, exchange control, government monopoly of foreign trade, all these weapons were drawn from the varied armoury of the political control of international trade. Two underlying forces were discernible, then as before, namely, the dread of war and the desire consciously to control those economic forces which had been expected by the founders of modern political economy to achieve without control (save within strict limits) the greatest good of the greatest number. In this particular period, point and urgency were lent to those forces by the existence, in several of the great commercial countries, of unemployment on a scale and of a duration never previously experienced.

(c) *International Lending, War Debts, and Reparations*

One of the most important causes of unemployment and economic nationalism was the distortion of economic life by great internal and international debts which were not represented by any countervailing economic asset. Of these, reparations was much the most serious in its political and economic consequences. Estimates of what Germany paid in reparation up to 1923 vary widely, but most of the discrepancy is due to differences in the valuation of external assets transferred (such as merchant ships and state property in ceded territories), which are of little interest in connexion with international trade and finance. It is fairly generally agreed[1] that actual transfers across the exchanges up to the end of 1922 totalled approximately 5 milliards of gold marks (£250 millions gold), including only 2 milliards (£100 millions) paid in cash. During that period, however, Germany had a large debit balance on her foreign trade, so that while she paid reparations fiscally and financially she did not pay them commercially and economically. The payments were balanced by the sale of mark currency (which represented a dead loss to foreign speculators) and of internal assets.

Then came the invasion of the Ruhr and the collapse of the mark, which is described later in this chapter. The Dawes

[1] See H. G. Moulton and C. E. McGuire, *Germany's Capacity to Pay* (New York, 1923, Macgraw Hill). Also the documents of the Reparation Commission.

Plan, which ended that period of German economic history, was ratified in August 1924. It laid down a five-year sequence of annuities, rising from 1,000 million gold marks in 1924–5 to 2,500 millions in 1928–9, which was to be regarded as the standard year. The annuities covered all Germany's treaty liabilities, and the only supplement was to be the service of the Dawes Loan of 800 million gold marks; this sum was raised for Germany on the world's capital markets in order to help her to pay the first Dawes annuity while she was still passing through a period of reconstruction. Specific securities were assigned for the service of reparations and the Dawes Loan, and foreign commissioners were appointed for the German state railways and the Reichsbank, under an Agent-General for Reparations. After 1928–9 the standard annuity would be varied according to an index of German economic prosperity and according to changes in the purchasing power of gold. The annuities were to be paid to the Agent-General in marks, and the responsibility for their exchange into other currencies rested with a Transfer Committee of exchange experts.

The annuities under the Dawes Plan were punctually paid up to the end of the standard year (1928–9). But in spite of its success in securing the restoration of German economic stability and in providing a steady flow of reparation payments, the plan was seen to have several defects. It failed to determine Germany's capital debt or the length of time for which the annuities must continue to be paid. It left certain vital parts of her economic structure under the control of foreigners. On the other hand, it threw upon her creditors the responsibility for transferring the payments across the exchanges, and its conditions were such that they could not 'mobilize' reparations, that is to say, issue bonds to the public on the security of reparation payments. The raising of the standard annuity of Rm.2,500 millions (£125 millions) was plainly proving a matter of difficulty for the German Budget. These defects the proposals of the expert committee under the chairmanship of Mr. Owen D. Young, which was set up in February 1929, by agreement between Germany and her reparation creditors, were designed to remedy.

The Young Plan established a schedule of annuities beginning with 1,707·9 million marks in 1930–1, the first full year of the plan, and rising to 2,428·8 million marks in 1965–6, when the period of 'reparations proper' was to end; thereafter the annuities were to cover only the net inter-governmental debt payments of the creditors and, after reaching a maximum of 1,711·3 million marks in 1980–1, would fall away to 897·8 million marks in 1987–8, when reparations would cease. The annual average of the annuities from 1929 to 1965, calculated on the basis of present values at 5½ per cent., was 1,988·8 million marks, which, it will be seen, was substantially less than the standard Dawes annuity. The service of the Dawes loan was to be an addition to these sums. Each annuity was to be divided into two parts, both of which would normally be paid in foreign currencies, though the transfer of the conditional portion into foreign currencies and, to a less degree, its payment in marks to the account of the creditor Governments might under certain circumstances be postponed. The unconditional portion, which the experts described as 'a conservative amount', commanding 'instant acceptance by well-informed public opinion', was fixed by them at Rm.660 millions, including the service of the Dawes loan, but this was later altered to Rm.612 millions *plus* that charge. Normally the German Government would be responsible for the payment of both portions of the annuity in currencies other than the reichsmark.[1]

The ending of the Young Plan by the Hoover Moratorium of 1931 is described in a later chapter. The sums actually paid by Germany under the Dawes and Young Plans up to July 1931 totalled 10,401 million gold reichsmarks, equivalent to roughly £500 millions gold.

In the view of the countries that owed war debts to the United States, but not of the United States herself, the questions of reparations and war debts were inextricably bound up, since their capacity to pay debts depended to a large extent on how much they could extract from Germany. The 'Balfour Note' policy, to which Great Britain persistently

[1] The above two paragraphs are reprinted by permission from the Reparations and War Debts Supplement to the *Economist* of 23rd January, 1932.

adhered, laid down that although her Allied debtors owed her twice as much as she owed the United States, not counting her claim to reparations, she desired to make no net profit, but only to receive as much as she had to pay on account of debts arising out of the war. In fact the funding agreements that she made with France and her other ex-Allies were much more favourable to the debtor than the agreement she was able to conclude with the United States. The latter allowed very different terms to the different debtors, partly in accordance with their economic capacity to pay, partly in accordance with their diplomatic bargaining skill, partly through the accidents of different dates of negotiation. Thus while the British schedule of annuity payments to the United States represented 82·3 per cent. of the full debt calculated on a $4\frac{1}{4}$ per cent. interest basis, the terms granted to France represented only 49·6 per cent. and those to Italy only 25·9 per cent. of the full debt.

The relatively fortunate position of France and certain other ex-Allies in the reparations and war debts complex is further brought out by an analysis of payments and receipts by the various countries up to the date of the Hoover moratorium. Great Britain, who received £121 millions in German reparations and £71 millions from allied war debts, paid £326 millions in war debt annuities to the United States, and was thus £134 millions the loser on balance. France, on the other hand, secured a net receipt of £163 millions, Belgium a net receipt of £119 millions, Jugoslavia a net receipt of £35 millions, and Italy a net receipt of £28 millions. The United States altogether received £451 millions from her various debtors, including Germany. These huge international payments inevitably distorted the normal economic and financial life of the world in the first post-War decade.

The debts directly arising out of the War had, meanwhile, been joined by a new series of semi-political debts arising out of the economic collapse that the War indirectly caused in Central and Eastern Europe. In spite of assistance from the Allied Powers, Austria collapsed financially in the summer of 1922. In September 1922 the Chancellor, Mgr. Seipel, laid the whole question of Austria's economic plight before the

Council of the League of Nations, and on the 4th October a scheme of reconstruction[1] was signed at Geneva. The main features of the project were three:

(1) The signatories, including Austria herself, mutually guaranteed her 'political and economic independence and territorial integrity'.[2]

(2) The creditor Governments each guaranteed a portion of the loan of 650,000,000 gold crowns which was to be furnished to Austria.

(3) The Austrian Government pledged themselves to balance the budget by the end of 1924, to cease borrowing from the Bank, and to create a new and independent bank of issue.

After the acceptance of this plan events moved swiftly. An internal short-term loan was taken up in November 1922. The Austrian Government adopted the required financial reforms. The Reparation Commission and the creditors for relief debt liberated the specific assets that they held as security. In February a guaranteed short-term loan of £3,500,000 was issued in six countries, to be replaced later in the year by a long-term loan, guaranteed by Great Britain, France, and Czechoslovakia as to 24·5 per cent. each, and as to 20·5 per cent. by Italy, the remaining 6 per cent. being guaranteed by Belgium, Sweden, Holland, and Denmark; *tranches* of the loan were floated in London, New York, Paris, Rome, Stockholm, Amsterdam, Brussels, Switzerland, Austria, and Prague, with complete success. The plan as a whole was satisfactorily carried through.

The success of the Austrian Reconstruction Loan encouraged repetition of the process. A Reconstruction Loan for Hungary was floated in 1924. The sudden influx of over a million refugees into Greece in 1923 forced her to apply to the League for assistance, and a settlement scheme was drawn up, involving the issue of an international loan, the proceeds of which were to be expended under the authority of an

[1] For further details of the reconstruction of Austria, see the *Survey for 1920–3*, pp. 231–328; the *Survey for 1926*, pp. 191–204; and below, p. 17.

[2] This clause was the ground of the adverse decision of the majority of the Judges of the Hague Court in the Austro-German customs union case in September 1931.

autonomous commission. In 1928 Greece raised a further loan under League of Nations auspices for the purpose of financial reconstruction as well as for further settlement work. Bulgaria followed the same course, borrowing in 1926 for refugee settlement, and two years later for financial reconstruction, in each case under the terms of a plan devised in consultation with the authorities of the League. Even more important, however, than the Reconstruction Loans were the issues made for the funding of reparations. The Dawes Loan, which has already been mentioned, was successfully floated in London, Paris, New York, Rome, Stockholm, Amsterdam, Brussels, and Switzerland. One of the essential features of the Young Plan was the mobilization of the reparation debt, that is to say, the sale to the general public of bonds the service of which should be a charge upon reparations, payable directly by the German Government, through the agency of the Bank for International Settlements as trustees for the issue. An issue[1] totalling roughly $300 millions in nominal value was successfully floated in June 1930, in the same centres as the former issue, together with Berlin.

To repair the havoc that the War had wrought in the finances of Europe naturally entailed the redirection of international capital resources towards the Old World. Before 1914, Europe lent to the world; after 1918, the world lent to Europe. Meanwhile the exigencies of the War itself had forced the chief European countries to liquidate many of their investments overseas, as well as to incur enormous inter-governmental war debts; Great Britain alone, it was estimated,[2] disposed of £750 millions of securities between 1914 and 1920, of which £650 millions were invested in the United States. Among the Great European Powers, Great Britain managed to retain her position as an international lender, but even her lending capacity was gravely impaired. Moreover, the calls which Europe made upon her depleted resources still further deprived the newer countries. It was estimated[3] that her net

[1] One-third of the proceeds was destined for German railway, post office, and telegraph requirements.

[2] *The Economist*, 15 Nov. 1930, p. 896. The figure excludes losses in Russia and Central Europe.

[3] Op. cit., loc. cit.

post-War investment in Europe, other than 'direct investments' and short-term loans, totalled nearly £300 millions up to the end of 1928, or nearly one-half of all her new investments, whereas at the end of 1915, according to Sir George Paish, less than 3 per cent. of her long-term investments abroad had been made in Europe, excluding Russia. It is obvious how greatly the world as a whole was thus forced to rely upon the United States for its needs of new capital. To what extent she fulfilled her task is shown in the following table:

*Public Issues of Foreign Securities in New York**

(*Nominal value*)

Year	$ (*millions*)
Average 1919–23	685
1924–6	1,274
1927	1,577
1928	1,488
1929	706
1930	1,086

* *The Economist*, 21 March 1931, p. 604.

The redirection of international investment towards Europe, and the reliance of borrowers upon the United States, were very important forces in the post-War economic world. The dangers of the situation became apparent in 1929, when the superior attractions of speculation in the Wall Street boom, and later the necessity for conserving funds in order to liquidate losses, caused the United States suddenly to curtail her foreign lending by one-half, a disturbance which greatly enhanced, if it did not actually cause, the subsequent acute dislocation of world trade and finance.

Another important aspect of post-War international capital movements was the readier interchange of existing securities. With the advance of such industries as oil and base metals, and the emergence of ever larger corporations, the number of international speculative counters increased, and more and more securities came to be quoted on markets other than those in which they had been issued. Blocks of the great international reconstruction loans were readily exchanged from market to market.

One of the greatest hindrances to international finance as

well as to international trade was the instability of currencies. Among the most important recommendations of the Financial Committee of the Genoa Conference of 1922 was one to the effect that central banks should collaborate in making the gold standard work successfully. But a combination of individualism, inertia, and semi-political nationalism prevented that recommendation from having any noteworthy result, though a certain measure of collaboration between the Federal Reserve authorities in New York and the Bank of England became apparent. The negotiation of new reparation terms gave the experts an opportunity for practical action. The design of an international 'central bankers' bank' may have arisen primarily from the need for establishing a non-political trustee for reparation transfers, but, as it was limned in the Young Report, that resolved itself into only one of its many functions, and a much wider usefulness was clearly envisaged. The Bank for International Settlements was conceived—to read between the lines of the report—as providing a means of doing three main things outside the field of reparations, namely, bringing the central bankers together regularly, and thus providing an opportunity for the development of an international credit policy; obviating wasteful shipments of metal as the international mechanism of the gold standard; and, most ambitious, providing a means whereby the world's resources of monetary gold might be used more rationally, and a greater structure of credit based on them without loss of security or public confidence.

These purposes were not expressly formulated in the outline constitution of the Bank, nor did they find recognition in its Statutes. Indeed, no one would deny that much further progress had to be made in the development of an international monetary policy and technique before the last two purposes could be substantially realized. In the actual conditions of the world's monetary gold supplies, ill distributed and likely to be inadequately renewed, any attempt of the Bank for International Settlements to secure a supply of its own, to be used as a basis of international credit or to be transferred from the account of one central bank to that of another without physical shipment, would only have aggravated existing

difficulties. The foundation of the Bank was nevertheless a milestone on the path of monetary progress. The machinery of an international credit policy had been created, though circumstances might prevent its being used for the time being. But the most important fact was the explicit recognition, by statesmen as well as by technicians, that a problem of international credit conditions did exist and must be grappled with by international co-operation, not primarily among Governments but among central banking institutions which should be, as far as possible, independent of political forces.

(*d*) *Currency and Exchanges*

The foundation of the Bank for International Settlements was the climax of a period of gradual readjustment and stabilization among the currencies of Europe. Stabilization was achieved on the basis of the international gold standard, but it was a very different system from the gold standard as understood and operated before the War.

The first great difference was that the circulation of gold coins, and the internal convertibility of paper currency, had virtually disappeared. In consequence, while the relation between gold reserves and internal liabilities diminished in importance, that between gold reserves and external liabilities at short term became more and more important. Had steps been taken to ascertain the total of external short-term liabilities—not merely of the Central Bank or Government but of the country as a whole—a comparison between that figure and gold stocks would have given a picture of the strength or weakness of the various note-issuing authorities very different from that given by their published reserve ratios, and very much more illuminating.

The second great change wrought by the War in the practice of the gold standard was the redistribution of gold. The table[1] on p. 14 needs some explanation. The net increase of $3,590 millions in the monetary gold stock of the fifteen countries came from three main sources:

[1] Gustav Cassel, *Money and Foreign Exchanges after 1914* (London, 1922, Constable), p. 67.

(*a*) Newly mined gold, amounting to about one-half of the increase.

(*b*) Countries not included in the table, notably Russia, who possessed $831 millions of gold at the end of 1915, most of which was subsequently exported.

(*c*) Gold extracted from circulation and private banks. The increase in the British reserves should be noted; at the time of the Armistice Germany's stock of gold totalled $607 millions, and France at one time during the War had amassed reserves to the amount of $968 millions.

Gold Reserves in the Hands of Governments and Central Banks, 1913 and 1921

(In $ millions)

	1913	*1921*	*Increase or decrease*
Belligerent States on the Continent			
France	678·9	688·3	+9·4
Italy	288·1	236·5	−51·6
Belgium	59·1	51·4	−7·7
Germany	278·7	260·0	−18·7
Austria-Hungary	251·4	0·0	−251·4
Total	1,556·2	1,236·2	−320·0
Great Britain	175·2	763·3	+593·1
Neutrals (and Japan)			
Sweden	27·4	75·5	+48·1
Norway	12·8	39·5	+26·7
Denmark	19·7	61·0	+41·3
Netherlands	60·9	245·6	+184·7
Spain	92·5	479·2	+386·7
Switzerland	32·8	104·9	+72·1
Argentine	225·0	450·1	+225·1
Japan	65·0	558·8	+493·8
Total	536·1	2,014·6	+1,478·5
United States of America	691·5	2,529·6	+1,838·1
Grand Total	2,954·0	6,543·7	+3,589·7

Apart altogether from the growth in their external obligations, the principal European belligerents were forced to make gold resources which were practically unchanged in nominal value

do the work of reserves whose purchasing power had been 50 per cent. greater. In addition to the withdrawal of gold currency from circulation, a lowering of the cash ratio maintained by commercial banks and the greater use of cheques in lieu of cash were among the changes that enabled the feat to be performed.

The third difference between the pre-War and post-War gold standards arose out of the shortage of gold in Europe, namely, the development of the 'Gold Exchange Standard'. A country adopting the gold exchange standard held, as part of its legal reserves against the note issue, obligations payable at sight in terms of foreign currencies which were themselves legally exchangeable into gold—commonly termed 'devisen'. Among the countries that adopted this indirect method of backing their currencies with gold were Austria, Czechoslovakia, Italy, Rumania, Finland, Estonia, and Jugoslavia. Against the advantage of this device, in economizing gold, must be set the corresponding disadvantage that dislocation in one national currency could cause much more direct and violent dislocation elsewhere than would occur if each country had its own private store of gold. The full force of this danger was not felt until 1931, when one of the chief gold standard countries was forced to relinquish the system, and the sterling bill and sterling exchange suddenly ceased to be as 'good as gold'.

The fourth difference wrought in the gold standard system by the War of 1914–18 was an aspiration rather than an accomplishment. The gold standard was no longer regarded by bankers or by the informed public as a mechanical and foolproof device. 'People now realize that a deliberate regulation of the monetary demand for gold is possible and may be an important influence on the value of gold.'[1]

For a number of reasons the automatism of the pre-1914 gold standard was impossible in post-War conditions. The spread of economic nationalism made it difficult to adjust trade balances to meet monetary pressures. The importunate demands of borrowers whose necessities were caused directly

[1] Gustav Cassel, *Post-War Monetary Stabilization* (Columbia University Press, 1928), p. 70.

or indirectly by the War raised the world rate of interest to an artificial level, and put a severe strain on the economy of lending countries. The peculiarly inflexible monetary system of France prevented an influx of gold from having its full inflationary effect in the country. The growth in the power of trade unions, cartels, combines, and price-fixing organizations to resist downward movements of wages and other prices handicapped any deflationary policy designed to correct the balance of trade. The enlargement of international debts, and especially the existence of vast governmental debts arising from the War, added new, overwhelming, and exceptionally obdurate items to the balance of international accounts. The speculative attractions of Wall Street, and then the outbursts of public distrust occasioned by commercial failures and financial scandals in one centre after another, set currents flowing in the stream of international payments which were far too swift to be deflected by the ordinary instruments of banking policy. Equally uncontrollable eddies resulted from political disturbances.

Another deeply planted obstacle to the normal working of the gold standard was the stabilization of European currencies at new values in relation to gold which often proved too high or too low, having regard to relative price levels and to other long-term factors determining the true economic value of one currency in terms of others. In order to appreciate this factor, it is necessary to go back into the more detailed history of post-War currency conditions.

During the War of 1914–18 the principal European belligerents were forced to suspend the convertibility of their paper currencies, all of which then depreciated against gold. Even the United States, after she entered the War, temporarily went off the gold standard, and the dollar was quoted at a considerable discount in certain neutral markets. Countries like Argentina, Brazil, and the Scandinavian group, whose currencies the circumstances of war tended to strengthen, also suspended convertibility. The freedom of currencies to fluctuate in relative value was, however, limited by the grant of inter-Ally credits on a large scale. At the end of the War, when the dollar was worth about three-quarters of its par

value in terms of Swiss francs, sterling was worth about 98 per cent. of its dollar parity, the French franc about 88 per cent., and the Italian lira about 54 per cent. The Russian rouble had depreciated by about 80 per cent. against the Swiss franc, the German mark by 40 per cent., and the Austrian crown by 60 per cent.

After hostilities had ended, the dollar quickly recovered and even rose above par on Switzerland. The unpegged pound could not follow it, but the adoption, at the end of 1919, of the Cunliffe Committee's proposal, that the uncovered note circulation should be progressively reduced, helped to strengthen sterling. The franc and the lira fell sharply when artificial support was removed, the former to less than half, the latter to about one-quarter, of gold parity; budgetary deficits, internal inflation, and adverse trade balances were the rule in France and Italy. The currencies of the defeated countries dropped swiftly to a small fraction of their gold value, but they did not at once collapse utterly. The trade boom of 1919–20 and the subsequent slump further disorganized the currency systems of the world.

France's budgetary difficulties contrasted with the deflationary public finance of Great Britain. The French franc, which had touched 47·40 francs to the £ in April 1922, sank to 72·20 francs to the £ before the end of that year. Largely because of the unfulfilled expectation of huge reparation receipts, the governmental expenditure of France at this time was approximately double what was raised from taxation and other revenue, without providing anything for interest and amortization on her foreign debt. On the other side of the reparations fence, the fall of the mark was also being rapidly accelerated. Other European countries subject to severe currency depreciation at that time included Yugoslavia, Hungary, Rumania, Greece, Poland, Austria, and Portugal.

The period of stabilization really began in 1923 with the reformation of Austrian currency and finance. The Treaties of Peace had left Austria an economic anomaly, a metropolis without an empire. A vast army of Government servants and an ill-balanced general economy combined to weaken her

public finances. Taxation continually fell a step behind expenditure, and as inflation resulted the crown depreciated. Plans for international assistance to Austria met with opposition and delay. Temporary credits granted by France and Great Britain were insufficient to stem the tide of depreciation. The Austrian crown, possessing a gold parity of 4·94 to the dollar, and having been worth about one-third of its par value when the War ended, was worth only 83,600 to the dollar at the end of August 1922, less than one-tenth of its exchange value only four months earlier. The League of Nations reconstruction scheme and the international loan to Austria have already been described. The depreciation of the crown was arrested in the autumn of 1922, and the budget deficit was wiped out before the end of 1923. By that time the currency had been legally stabilized on the gold exchange standard, a new currency, the schilling, worth 10,000 crowns, being introduced at a par value of 34·585 schillings to the £.

The stabilization of the Austrian crown contrasted with the collapse of the German mark. At the end of the War the mark was worth on the international exchanges about one-half of its pre-War parity, and the level of commodity prices and wages was about two and a half times as high as in 1913. The volume of means of payment was, however, fourteen times as great as the normal pre-War figure. In Germany, 94 per cent. of the cost of the War had been financed by borrowing.

After the War the history of German finance was largely a history of the attempt to recover reparations. During the first half of 1919 the Reichsbank delivered over 1,000 million marks of gold to Allied Powers in exchange for foodstuffs. In December 1921, when the German Government applied in vain for a moratorium, the mark was worth 60 to the dollar;[1] a year later it was worth only 9,000 to the dollar. Under the London Schedule of Payments, the creditors had demanded the delivery in cash, by September 1921, of 1,000 million gold marks, and it was the attempt to liquidate the short-term loans with which this was financed that precipitated the decline in the exchange value of the mark. On the 11th January 1923 French and Belgian troops marched into the Ruhr; by

[1] Pre-War parity was about 4·2 to the dollar.

the end of January the mark was quoted at 49,000 to the dollar. The restriction of non-governmental credit was powerless to prevent the inflation imposed by public expenditure in the Ruhr and elsewhere. During July 1923 the value of the mark fell from 160,000 to 1,100,000 to the dollar. The currency had become practically useless as a means of exchange or account, and in August 1923 taxation was imposed on a gold basis; foreign currency was entering into circulation, many wages being paid and contracts made in it. Values were also expressed in terms of commodities—rye, coke, coal, potash, even kilowatts. In August 1923 an internal loan for the establishment of a stable currency failed to secure sufficient public support.

The turning-point came in October, when passive resistance was formally abandoned by the second Stresemann Cabinet. This was followed by the creation of the Rentenbank, which was authorized to issue rentenmarks—a new currency altogether—in gold denominations on the security of a 5 per cent. first mortgage charge on all agricultural, industrial, and commercial capital. On the 26th October 1923 Monsieur Poincaré agreed to an inquiry into Germany's capacity to pay, and on the 14th January 1924 the Dawes Committee held its first meeting in Paris. By restricting the circulation, the newly appointed Currency Commissioner (Dr. Schacht) succeeded in pegging the exchange at 4,200,000 million marks to the dollar. The rentenmark, like the former gold mark, exchanged at 4·2 to the dollar, and was thus worth 1,000,000 million marks.

Attempts to restrict credit were continued, under the direction of Dr. Schacht, who became President of the Reichsbank in December 1923. Wholesale prices fell sharply and the balance of trade became more favourable. The flight of capital was reversed. The export of capital from Germany during the period 1919–23 has been estimated at 6,000 million to 7,000 million gold marks (£300–350 millions), and the total of foreign bank-notes imported at 1,200 million gold marks (£60 millions).[1] A stock exchange crisis and a trade slump

[1] James W. Angell, *The Recovery of Germany* (Yale University Press, 1929), p. 374.

supervened, but the currency had been secured. The Dawes Plan provided for the establishment of an independent Reichsbank and the restoration of the gold standard in Germany. The reichsmark was put into circulation in November 1924, at parity with the rentenmark.

There was a general move towards stabilization of European exchanges during 1924. Swiss francs and Swedish crowns reached parity with the dollar late in the year. Poland abandoned her former currency and maintained the new zloty close to par without external aid. Hungary, on the other hand, required an international loan for the stabilization of the pengö at 346,000 to the £ gold. An American loan to Belgium likewise raised the exchange value of the Belgian franc after it had fallen back a long way, and a loan floated in London and New York served to strengthen and stabilize the value of the Czechoslovak crown. The Finnish mark was stabilized, and Denmark also launched a stabilization scheme.

The immediate return of Great Britain to the gold standard was announced by Mr. Winston Churchill in his Budget speech on the 28th April 1925, and Holland restored the gold standard at the same time.

The War had wrought a very great change in the monetary system of Great Britain. The fiduciary circulation of the Bank of England (i.e. the circulation covered by securities and not by gold) was only £18,450,000 at the outbreak of war, whereas under the Act of 1928, amalgamating the note issues of the Treasury and the Bank, it became £260 millions. This huge increase did not imply a proportionate enlargement of the means of payment current in the country; in the meantime gold coins in circulation had been almost entirely replaced by notes of £1 and 10*s*. denomination. During the War many millions of gold were withdrawn from circulation or from the cash reserves of the joint-stock and private banks. At the end of 1913 the gold reserve of the Bank of England was £36 millions; when Great Britain returned to the gold standard in April 1925, it was £155 millions, including the Currency Notes Reserve. It was being used, however, to support an international banking business much more perilous for the monetary stability of the country.

There were two main reasons why the pound did not depreciate so far as the currencies of other European belligerents during the World War: first, because a comparatively large proportion, estimated at one-quarter, of the cost of the War was financed in Great Britain out of taxation; secondly, because the task of undoing the war-time inflation was taken in hand at once. The Budget actually produced a surplus in 1920–1. The Cunliffe Committee on Currency and Foreign Exchanges after the War presented its final report at the end of 1919. Its central recommendations were that the gold standard should be restored without unnecessary delay, and that the issues of Treasury notes and Bank of England notes should be amalgamated on the basis of a fixed fiduciary issue. It urged that the Government should refrain from issuing fresh loans and, indeed, begin repayment if possible; that the actual maximum fiduciary circulation in any year should become the legal maximum for the following year; and that the Bank should raise the discount rate and make it effective, with a view to accumulating gold. Deliberate deflation was assisted by the automatic deflation that accompanied the slump of 1921. Then followed a period in which the trade of the world expanded, and along with it confidence in sterling, while a measure of inflation in the United States helped the pound to climb back towards its former dollar value. Its rise was interrupted occasionally by minor movements and in 1924 by rumours of a capital levy. It was helped, however, by two powerful financial forces—the favour in which London was held as a repository for short-term funds from European centres, and the purchase of sterling by American and other financiers in the expectation that the gold standard would be restored.

In June 1924 the Chancellor of the Exchequer, Mr. Snowden, appointed a Committee to consider the amalgamation of the Treasury note and Bank note issues. The Committee, however, addressed themselves mainly to the cognate problem of the return to gold. While acknowledging that the existing dollar value of the pound, which was only 1½ per cent. below par, could be maintained only by a reduction of sterling prices, they argued that the necessary adjustment should be carried

out once and for all. The Committee therefore recommended that the early return to the gold basis should forthwith be declared to be the irrevocable policy of His Majesty's Government. This recommendation was carried out in April 1925. Even the supporters of the restoration of the gold standard at the old parity admitted that the pound was overvalued; their expectation was that in a period of financial stability the adjustment of relative national price levels could be brought about quite quickly and smoothly.

An incalculable factor in 1925 was the future of the French franc. Before the War the currency system of France had been what is known as the 'limping standard'—bimetallism with the qualification that only one of the metals, gold, was freely minted. France formed part of the Latin Currency Union. The Bank of France, like the Bank of England, was highly independent of the State. There was no legal reserve ratio, but the note circulation was limited to a maximum of 6,800 million francs. At the end of 1913 the Bank of France held 3,517 million francs of gold and 640 million francs of silver against a note circulation of 5,717 million francs.

The stability of this system was completely upset by the necessities of War finance. The accumulated deficits of the five Budgets of 1914–18 totalled 144,400 million francs. Of course this meant a big inflation of currency. The legal maximum circulation was raised progressively to 33,000 million francs. As a consequence, wholesale prices at the end of 1918 were about three and a half times as high as before the War. Nearly 2,000 million francs of gold (£80 millions) was squeezed out of circulation, but an equal sum was shipped abroad as collateral security for War credits. The external trade balance was, of course, extremely adverse, but the establishment of credits in New York and London and the control of foreign exchange dealings served to peg the franc at about 88 per cent. of its dollar parity.

After the War, budgetary deficits and currency expansion continued in France. The advances of the Bank of France to the State increased. In April 1920, wholesale prices in France being then six times as high as before the War, the French franc fell to one-third of its par value in terms of dollars. With

the international slump of 1921, the depreciation of the franc was arrested. In two years, wholesale prices were almost halved. Government borrowing at the Bank stopped and the circulation decreased. The inward commodity balance of trade, which had amounted to 23,000 million francs in 1920, dropped suddenly to 2,300 million francs in 1921. The adverse trade balance was more than covered by tourist expenditure in France. The dollar value of the franc remained fairly stable at about 40 per cent. of its pre-War level.

The turning-point came with the electoral success of the *Cartel des Gauches* in June 1924, and the formation of the Herriot Government. These events, so valuable in many ways to the progress of international amity after the harm wrought by the Ruhr invasion, were disastrous to the stability of the franc. An expensive social programme frightened capital and threatened budgetary breakdown. The Governments of MM. Herriot and Caillaux resorted once more to borrowing from the Bank of France, and also from the private banks. In December 1925 the maximum circulation was raised to 58,000 million francs and a limit of 38,500 million francs was set for Government borrowing from the Bank of France. By the summer of 1926 these maxima had been nearly reached. Meanwhile the external value of the franc had fallen precipitously, till the pound fetched 240 francs, nearly ten times as many as at par. But this was not the consequence of any adverse balance of trade following the rise of internal prices; on the contrary, the surplus of imports of 2,256 million francs in 1923 was changed into a surplus of exports of 1,322 million francs in 1924 and of 1,660 million francs in 1925, while tourist expenditure in France, encouraged by the favourable rate of exchange, steadily increased. The depreciation was due to the outflow of liquid funds and even to the sale of francs by small rentiers in France, who, with the spectre of German inflation vividly before their eyes, feared that they might lose all that they possessed.

In August 1926 the *Cartel des Gauches* was defeated and Monsieur Poincaré assumed office. He immediately proceeded with the task of restoring the public finances, imposing 13,000 million francs of new taxation, and the 1926 Budget

closed in equilibrium. The mere promise of these measures immediately attracted money back into the country, and by the end of the year the franc was back at 122½ to the pound. In March 1927 the franc was officially 'pegged', though not legally stabilized, at a little more than 124 to the pound sterling. The external appreciation of the franc, coupled with the internal deflation, caused a minor slump in France, but her foreign trade was little hurt. In 1926 imports almost exactly balanced exports, while tourist expenditure provided 13,000 million francs of foreign exchange,[1] and in 1927 the outward balance of trade amounted to 2,375 million francs.

The franc was, in fact, and continued to be, undervalued in relation to its purchasing power. The outflow of funds in 1926 had proved as deceptive as the inflow of funds to London in 1925 (much of which was indeed fleeing the perils of the franc). Hence the Bank of France was able to go on buying gold and foreign exchange. The disequilibrium would presumably have been corrected if the payments for these purchases had been allowed to influence the circulation, and thereby the level of prices, to their full extent, but most of them returned to the Bank either through a reduction of borrowing by the Government or by way of ordinary deposits. Wholesale prices actually fell by 3½ per cent. in 1927.

On the 2nd June 1928 the gold convertibility of the French franc was restored at a rate equivalent to 124·21 francs to the pound sterling. At that time the gold reserves of the Bank of France amounted to 5,543 million francs, besides several milliards of devisen (mostly deposits in London and New York). This accumulation of short-term assets abroad was, for the following three years, a sword of Damocles over the heads of the other great international monetary centres.

Meanwhile the process of stabilization had continued in Europe. Having raised a loan of £20 millions in London, Belgium stabilized in October 1926 at the rate of 175 francs to the pound, at the same time introducing the 'belga', equivalent to 5 francs, for foreign exchange purposes. The restoration of the gold standard in Denmark was foreshadowed by the raising of a loan of £3 millions in London. Czechoslovakia,

[1] Estimate of P. Meyniale, *Revue d'économie politique*, March–April, 1927.

having achieved *de facto* stabilization in 1925 on a dollar basis, kept the exchange steady with the aid of a revolving credit granted by American banks in May 1926.

In 1927 the number of currencies subject to large exchange fluctuations was still further reduced. The par value of the zloty was reduced from 25·22½ to the pound to 43·38 to the pound and the gold standard was established. Outside Europe, the important decision was taken to fix the value of the Indian rupee at 1*s.* 6*d.*, and to dispose gradually of the silver reserves. After depreciating as a result of political rumours and of difficulties between Italy and Yugoslavia, the lira was stabilized on a gold basis at 92·46 to the pound against a pre-War rate of 25·22½. Credits of £25 millions each had been made available in London and New York for the defence of the exchange. The countries which stabilized in 1928 included Luxembourg, Norway, and Bulgaria.

But already the clouds were beginning to form that eventually broke in the financial cyclone of 1931. The Reichsbank continued its policy of acquiring gold, and the sale of Germany's banking assets abroad, combined with the flow of money to the United States, so much weakened sterling that there was a considerable outflow of gold from London, which was being forced to take, with inadequate resources, the place of New York as the financier of Europe.

In the first half of 1929, exchange movements were dominated by the Wall Street boom and the consequent spate of money to New York. The weakness of sterling resulted in a steady flow of gold from London in the summer. Most of this went to France, which imported £40 millions worth of gold in the second half of the year, mostly from London, but later on, after the stock exchange crash, from New York also. During the year ended the 30th June 1929 the Bank of France sold nearly £80 millions of foreign exchange. In April the threat of a breakdown of the work of the Young Committee of Reparation Experts, then meeting in Paris, depressed the reichsmark so far that Germany exported over £40 millions of gold in a month.

After the break of stock prices in October the whole face of the foreign exchange market changed. Sterling immediately

improved, actually reaching a level at which it was profitable to import gold from the United States. At the same time the currencies of the raw material-producing countries, such as Australia, Canada, and the Argentine, depreciated so far that all those three were forced to abandon the practice of the gold standard. The Australian Commonwealth Bank Bill authorized the prohibition of gold exports; Canada, while continuing to claim the title of a gold standard country, placed a practical embargo on the export of gold, which would have been profitable at the low rate of exchange then ruling; and, in spite of the possession of a large stock of gold,[1] the Argentine Conversion Office suspended gold payments. On the other hand, Switzerland formally adhered to the gold standard in 1929, and Czechoslovakia likewise stabilized her currency *de jure*. Under the influence of financial reforms the yen greatly improved in value, so that by the end of the year preparations were on foot for its stabilization.

By 1930, therefore, the period of the return to the gold standard was virtually ended, and the period of its relinquishment under the pressure of the world slump had already begun. In Europe the only important currency still subject to large fluctuations was the peseta, which lost over one-quarter of its value during the year. Among the great financial Powers, however, the operation of the gold standard continued to cause serious difficulties.

From this necessarily curt and disjointed narrative two outstanding facts emerge. The great task of restoring stability to European exchanges, after the war-time upheaval and the post-War inflations, was accomplished only with the aid of international co-operation. Time and again, in Germany, Italy, Austria, Hungary, Czechoslovakia, Belgium, Denmark, and elsewhere, the raising of a foreign loan or open credit was an essential part of the process of currency stabilization. The second prominent feature of post-War monetary history was the decisive part played by political distrust or confidence. The insistence of the former Allies on extravagant scales of reparation payments sapped public faith in Germany's economic and political stability, and the consequent depreciation

[1] $427,416,000 at the end of 1929.

of the exchange value of the mark was proportionately far greater than the internal expansion of the circulation. In France, too, the exchange fluctuations were on a much larger scale than was indicated by any conditions of internal finance, largely because confidence in the financial soundness of her Government ebbed both at home and abroad. In determining the course of post-War currency exchange, movements of capital were in the short run of much greater moment than factors based on commodity prices and trade.

The post-War gold standard was being undermined, not only by elements of political and financial instability, but also by troubles affecting gold itself. The effect of the War on the gold reserves of the various countries has already been mentioned. Losses of gold, combined with the higher level of prices, compelled Europe to economize in the use of gold. Moreover, the increase of the world's gold reserves through new production was smaller than before the War, both absolutely and relatively, as the following table shows:

World Production and Consumption of Gold

(In £ millions)

	1910–14	*1915–19*	*1920–4*	*1925–9*
World's gold output . .	470	430	359	413
Industrial absorption .	120	91	87	75
India	96	51	104	91
China and Egypt . .	7	14	−2	3
Balance available as money	247	274	170	244
Stock of gold money* .	1,647	1,922	2,092	2,336
Percentage increase .	*17·6*	*16·7*	*8·9*	*11·9*
World's population* (millions)	1,748	1,811	1,890	1,990
Percentage increase .	*4·9*	*3·6*	*4·4*	*5·3*

* At end of period.

The world's monetary gold stock increased, it is true, twice as fast as the world's population. But trade, and hence the use for money and credit, increased, up to 1929, much faster than the population. It was generally estimated by experts that the normal monetary need for new gold was equivalent to an

increase of about 3 per cent. per annum, whereas the average increase from 1920 to 1930 was only 2·1 per cent. per annum. Moreover, the new gold was not, on the whole, finding its way to the centres where it was most needed. It is true that between 1925 and 1930 the United States relinquished a little gold to the rest of the world, and that Germany almost doubled her reserve; but France gained an enormous quantity when, after stabilizing the franc, she proceeded to liquidate her foreign exchange holdings, while Great Britain, having painfully and slowly augmented her store, lost in 1929 almost all she had previously gained. The chief movements may be seen from the table below:[1]

Monetary Gold Reserves

(In $ millions)

	End of year						*Increase*
	1913	*1925*	*1926*	*1927*	*1928*	*1929*	*1925–9*
France	1,700	1,066	1,066	1,065	1,259	1,631	565
Germany	995	303	452	460	666	560	257
Italy	306	221	223	239	266	273	52
Spain	93	490	493	502	494	495	5
United Kingdom	770	712	743	750	754	719	7
U.S.S.R.	1,941	94	84	97	92	147	53
Canada	162	226	230	229	191	151	*−75*
U.S.A.	1,924	4,399	4,492	4,379	4,141	4,284	*−115*
Argentine	285	459	459	540	619	445	*−14*
India	124	109	109	119	124	128	19
Japan	86	576	562	542	541	542	*−34*
Australia	198	279	232	220	223	185	*−94*
World (including other countries)	8,773	10,232	10,495	10,610	10,949	11,179	947

A possible measure of 'maldistribution' of gold was the surplus or deficiency of reserves above or below a fixed percentage of the notes and other sight liabilities of the central

[1] Drawn from the *Interim Report* of the Gold Delegation of the Financial Committee of the League of Nations (League of Nations document C. 375, M. 161, 1930). The apparent discrepancy between certain of the above figures and those of Professor Cassel, reproduced on p. 14 above, arises from the difference in estimates of the quantity of gold in circulation and in the hands of commercial banks.

banks. On this basis, with a 40 per cent. standard ratio, the following had deficiencies of the stated amounts (in gold pounds) at the end of 1929: Germany, £19 millions; Italy, £25 millions; United Kingdom, £66 millions; Belgium, £2½ millions; Brazil, £1 million; India, £27½ millions. The U.S.S.R. appeared to have only a 5 per cent. ratio, and a number of other smaller countries were also deficient. The countries with a surplus of gold included the following: U.S.A., £272 millions; France, £52 millions; Spain, £25 millions; Argentina, £41 millions; Japan, £23 millions; Australia, £1½ millions; the Netherlands, £7½ millions; Switzerland, £4½ millions; Canada, £17 millions.

The maldistribution of gold was the result of a fundamental maladjustment between commercial and financial factors in the world's economy. For that maladjustment, many things contributed a share of the responsibility—tariff barriers and other manifestations of economic nationalism; ill-advised lending or, conversely, refusal to lend, inspired by non-commercial considerations; the disorganization of public finances and of foreign exchanges after the War; the creation of a huge volume[1] of international 'ready money' which might, under the stimulus of a panic or a boom, move rapidly from centre to centre; the existence of large international obligations (reparations and war debts, and at least some of the post-War loans to Governments) against which there could be set no equivalent productive asset of the debtor. These general and world-wide forces all contributed to bring about the maldistribution of gold, which in its turn, by inducing local credit stringencies, undoubtedly accelerated the fall of prices.[2]

On the purely financial side, the forces producing an irrational movement of gold included the peculiar rigidity of the French monetary system, which prevented the gold influx from having its full proportional effect on the note circulation and thus on prices, and the inability of the central banking authorities in the United States to prevent the excessive speculation, whether in foreign or in local securities, which so

[1] Estimated by the Macmillan Committee at £1,000 millions in London and New York alone.

[2] See below, p. 34.

distorted the international system. From the autumn of 1927, when a policy of cheap money was initiated by the Federal Reserve Board, to June 1928, the United States lost nearly $600 millions of gold, most of it to France but a good deal to South America and some also to Germany and other European countries, even to Great Britain. Then the Wall Street boom began, with its attractive effect upon funds all over the world, and in the autumn London, which had been losing gold to Germany, was forced to send consignments to New York also. In the first three quarters of 1929 the United States gained nearly $400 millions of gold, while the Bank of England lost £23 millions. After the break in stock prices in October the movement was reversed, America losing £25 millions before the end of the year and England gaining £15 millions. Germany, Australia, and Argentina had also been among the principal sufferers from the gold-suction. In 1930 the drain upon the debtor countries was resumed; Japan lost £32 millions and Brazil £25 millions, while the United States gained £41 millions and France £90 millions—more than the whole output of new gold during the year. The following table is taken from the Macmillan Committee's report:

Gold in Central Banks and Treasuries

(In £ millions)

	1st Jan. 1929		*1st Jan. 1930*		*1st Jan. 1931*	
Creditor countries	1,277	65 *Per cent.*	1,391	69½ *Per cent.*	1,564	74½ *Per cent.*
Debtor countries	680	35	610	30½	531	25½

The Committee added that much of the debtor countries' gold was held by those which were least hard-pressed, and that probably at least two-thirds of it was immobilized under laws regulating their gold reserves. By the beginning of 1931, therefore, the state of the world's monetary gold reserves, and the movements that were proceeding between them, already foreshadowed the breakdown of the system.

A study of the price of silver is a convenient bridge from currency history to an account of commodity prices in the post-War period; for while silver was a monetary metal for some parts of the world its price-fluctuations in relation to

gold were in many ways akin to those of other commodities. During the War the price of silver rose enormously. India and China, by supplying the belligerents, built up surpluses on their international balances which they liquidated in traditional fashion by adding to their hoards of precious metal. The British Government made a special purchase of 200 million ounces of silver from the United States to coin rupees for the Indian troops. Above all, in the absence of any fixed monetary relation between the two metals, silver behaved like other commodities in respect of its gold price, and the gold prices of commodities in general rose steeply during and immediately after the War. Later they fell steadily, and the price of silver fell with them.

The highest recorded price for silver was touched on the 11th February 1920, when standard silver fetched 89½*d.* per ounce for cash in London. Less than ten months later the price was under 39*d.* per ounce. When the price was high, India became a seller of silver, the bullion value of the rupee having been driven above the regulated sterling rate (then 2*s.*). The British Government obtained powers from Parliament to debase the quality of the silver coinage, which likewise threatened to be worth more as metal than as money, and other European countries took similar steps. Sales of demonetized silver began to influence the world market very powerfully. At the same time famine in China reduced the purchasing power of that country, while on the production side Mexico, under an unwonted régime of order, resumed her place among the world's chief producers of silver. On top of this, the sterling price of silver naturally fell as the pound appreciated in terms of gold and as the purchasing power of gold itself increased. The fall would probably have been larger but for the fact that after the open-market price had fallen below a dollar an ounce the whole of the American output was bought at that price by the United States Mint under the Pittman Act, and one-quarter of the world's supply was thus taken off the outside market.

In 1921 there was a further fall, a low level of 30⅝*d.* per ounce being reached on the 5th March. The rupee could not be held at its former level and fell to a rate of 1*s.* 4*d.* on London.

The Indian bazaars were buying silver heavily now, but stocks in China were piling up and the market was affected by big sales of demonetized silver as well as the rising production of new silver. Nevertheless, despite the larger supply, the cessation of purchases under the Pittman Act in 1923, and the disorganization of the Chinese market through civil war, the price of silver remained fairly stable for four years. Though practically the whole of the world's silver supply had to be absorbed by China and India, they were, nevertheless, equal to the task.

The Report of the Royal Commission on Indian Currency and Finance, published in August 1926, recommended that India should adopt the gold bullion standard and that the silver reserve should be reduced from its actual level of 85 crores (£64 millions at the rate of 1*s*. 6*d*. to the rupee, which the Commission recommended) to 25 crores (£19 millions) in ten years. The Commission suggested the sale of rupees as bullion, while the future coinage of rupees was to be indefinitely postponed. On the publication of these proposals there was naturally a slump in the silver market.

Sales of demonetized silver from India and Europe continued to depress the price of the metal. The prospect of a restoration of the gold standard in Japan at the end of 1929, moreover, caused China merchants to 'go bull' on the yen and to 'go bear' on silver. At the end of 1929 the cash price of silver had fallen to $21\frac{7}{16}d.$ and the next phase of the decline had begun. A notable feature of the silver market for some years had been the apparent ease with which China absorbed the enlarged world production, but by the end of 1929 she appeared to have reached saturation point, stocks in Shanghai having almost doubled in two years.

In 1930 the decline of price continued, and at the end of the year an ounce of standard silver fetched only $14\frac{7}{16}d.$ Disturbed political conditions reduced the demand of the Indian bazaars, and Indo-China sold silver on the adoption of the gold standard, which was accomplished in March. The report of the Kemmerer Commission on Chinese currency recommended the gradual adoption of the gold standard, and although the proposal could not be put into effect the excessive stocks of

silver in China showed no signs of being absorbed. It is estimated that the volume of demonetized silver coming on the market in the year included 30 million fine ounces from India, 23 million fine ounces from France, and 18 million fine ounces from Indo-China. On the 9th February 1931 the cash price of silver fell to the record low level of 12*d.* per standard ounce. Meanwhile some correction was being afforded by the decline of new production from a peak of 262 million fine ounces in 1929 to 244 million fine ounces in the following year. The fall in production would doubtless have been greater, under the play of ordinary economic forces, had not a large proportion of the output originated as a by-product of base metal-smelting.

The sterling fall in the value of silver during those ten years —from a maximum of over 7*s.* an ounce to a minimum of 1*s.*— was of course profoundly important to the Far East, especially to China, where silver was the principal medium not merely of capital accumulation but also of circulation and account. A depreciation of silver acted like a depreciation of any other currency against gold; it stimulated China's exports by lowering their price in terms of gold currencies, and conversely restricted her imports.

The extent of the depreciation of silver values must not be exaggerated. In many respects 1920 was an abnormal year, and the high level of silver prices then ruling was artificial and necessarily evanescent; for it drew forth the hoards of India and forced European countries to debase or abolish their silver coinage. At the end of 1920 the sterling price of silver was still about 57 per cent. above the pre-War price, and represented far more exactly the 'natural' value of silver than had the inflated prices of the earlier months. From 1921 to 1925 the average cash price of standard silver in London was 33·8*d.* per ounce; from 1926 to 1930 it was 24·7*d.*—a fall of 27 per cent. Between those two periods sterling prices of wholesale commodities in general (Board of Trade index) fell by over 18 per cent., so that the net depreciation of silver, in terms of purchasing power, was under 10 per cent. A similar conclusion is reached if prices at the beginning and end of the ten years are compared. The relative fall of silver prices was

remarkably small considering the impoverishment of China through civil strife, the political uneasiness of India, the demonetization of silver in European countries, the adoption of the gold standard and the sale of silver by India and Indo-China, the increase of new production far above the pre-War record, and the failure—because silver was only a by-product—of large portions of the supply to respond to price variations.

(e) *The Fall in Prices*

Behind the currency difficulties big changes were taking place in the structure of prices and the distribution of trade and industry. The cessation of warfare was followed by a tremendous boom, with soaring prices, feverish industrial activity, wild dreams of wealth; less was earned than was spent, less was saved than was spent on capital goods. Then, in 1920 and 1921, the boom collapsed, and prices too, with demoralizing swiftness. Setting cyclical movements aside, there was, thereafter, a long-run decline in commodity prices. No country intended it and none was able to withstand it. From 1923 to 1929 (a period beginning after the headlong fall of prices in 1921 had worked itself out, and stopping short of the almost equally rapid fall in 1930), indices of commodity prices compiled on the same basis for the different countries showed a fall of 20 per cent. in Great Britain, 11 per cent. in Sweden, 12 per cent. in Holland, and 10 per cent. in the United States.[1] The greater amount of the fall in Great Britain reflected her successful efforts to restore the pound sterling to its pre-War parity with the dollar.

This fall in prices, though it was unmistakable over the period as a whole, and was shared by almost every important commodity in greater or less measure, was neither continuous nor evenly divided between the different articles. 1925 and 1929 were conspicuously years when average prices rose above the trend. Wheat was at its highest price in 1925, pig-iron and

[1] Figures published by the London and Cambridge Economic Service, *Special Memorandum No. 24*, July 1927, and subsequent bulletins. No exactly comparable figures exist for Eastern countries, but it may be noted that the Calcutta index of Indian wholesale prices fell by 18 per cent., and the index of Japanese wholesale prices published by the Bank of Japan by 17 per cent., during the same period.

steel rails in 1923, chilled beef in 1928, and frozen mutton in 1923; tin and sugar at the turn of 1926 and 1927, rubber and jute at the turn of 1925 and 1926, Egyptian cotton a year previously, and American cotton a year before that. The fluctuation in the prices of some commodities was enormous, rubber being a notorious instance. Among those with approximately 100 per cent. difference, or more, between the highest and lowest prices over the eight years were tin, sugar, coffee, jute, silk, wool, and cotton.

The effects of the general fall of prices on international relations were many and various. Those countries which relied mainly on one or two articles of commerce for their prosperity showed themselves liable, when the prices of those commodities suffered violent fluctuations with a downward trend, to equivalent fluctuations of political feeling with a general tendency to discredit the established order. Brazil, for instance, relied for external purchasing power principally on coffee, Argentina on beef and wheat, Chile on nitrates, Mexico on silver and oil, the West Indies on sugar; countries such as these were at a disadvantage compared with those possessing diversified exporting industries. Their difficulties were enhanced by the existence of large foreign debts, since the effort to maintain a balance of trade which would pay the debt service and make up for the cessation of new imports of capital still further depressed prices and discouraged investors. Grave economic strain must, in any case, have been set up by a decline in prices under a régime of heavy international indebtedness, which had to be discharged with a progressively greater total of goods.

Internally, a fall in prices would tend to induce business discouragement, a reluctance to invest either in stocks of goods or in capital equipment. This would help to augment the decline in prices, while causing unemployment in industry. These were the conditions under which economic nationalism throve. Insulation was demanded against the world fall in prices. Claims were put forward that the internal standard of living, artificially swollen by the fall in commodity values, must be protected against 'cheap foreign labour'. Budgets would not balance under these conditions, and,

especially in free-trade countries, fiscal arguments for a tariff were cogently adduced. Thus the course of commodity prices since the War was responsible in no small measure for the nationalist streak across the internationalist background of post-War politico-economic affairs.

Two main forces seem to have contributed to the world fall in prices, which was, of course, a change in the relation of money to goods. The first was 'on the side of money', namely, what is commonly known as deflation, and the second was on the side of goods, namely, a decrease in the real cost of production.

The monetary causes making for deflation have been described in the previous section. In the course of the uncoordinated reconstruction of currencies after the War, some became overvalued and some undervalued in relation to a common standard. Where there was overvaluation, as in Great Britain, deflationary 'slimming' was necessary in order to preserve stability and retain gold. On the other hand, the countries whose currencies were relatively undervalued, like the dollar and the French franc after 1926, failed, over the period as a whole, to provide sufficient compensation in the form of internal inflation or external lending.

It is impossible to measure, from the available statistical evidence, the relative weight of the various forces that were making for a decline of commodity prices. But it seems probable that over the period 1922 to 1929 unnatural stringency was not more powerful in procuring such a decline than were changes on the side of production. The increase of industrial productivity was one of the most striking facts with which the International Economic Conference of May 1927 was faced. The first of the tables opposite is taken from a document laid before the Conference.[1]

The document in question appended several reasons why these figures, which were drawn from many different sources and were of varying reliability, should have underestimated the advance in production generally.

'In the first place, saving in Europe has diminished, with the

[1] *Summary Memorandum on Various Industries.* (Document No. 19 of the International Economic Conference, League of Nations, 1927.)

1925 Production as a percentage of 1913

	Europe (excluding Russia)	World
Coal and lignite	93	99
Petroleum	104	267
Pig-iron and ferro-alloys	84	98
Raw steel (ingots and castings)	100	118
Shipbuilding	66	66
Mechanical engineering	90	108
Electrical engineering	146	201
Sulphuric acid	99	126
Nitrogen	249	163
Superphosphates of calcium	104	113
Cotton mill consumption	88	108
Natural Silk	101	156
Artificial silk	546	660
Sugar (cane and beet)	112	142

*Indices of World Production, 1920–9** (1920 = 100)

Commodity	*1921*	*1925*	*1929*
I. *Metals and Minerals*:			
Coal and lignite (in terms of coal)	82	101	112
Petroleum	111	154	212
Pig-iron and ferro-alloys	61	122	156
Steel (ingots and castings)	62	127	168
Copper (smelter)	57	146	204
Lead	83	140	160
Zinc	61	162	207
Tin	76	121	156
Aluminium	59	143	214
Nickel	33	120	175
II. *Chemicals*:			
Natural phosphates (22 countries)	84	130	162
Nitrate of soda (Chile only)	52	100	129
Sulphate of ammonia (17 countries)	106	185	270
III. *Textiles (Raw)*:			
Cotton†	79	143	130
Wool‡	..	105	120
Raw silk	112	145	183
Artificial silk‡	..	240	558
IV. *Tropical Products*:			
Cane sugar†	113	142	151
Coffee†	109	110	159
Cocoa	105	138	144
Tea (excluding China)	87	117	139
Rubber	86	170	254

* Compiled from the *International Statistical Year Book*, 1929, published by the League of Nations, supplemented by documents of the International Economic Conference, 1927.
† For these commodities, the crop year, e.g. of 1925–6, has been taken as 1925.
‡ 1922 = 100.

result that the demand for capital goods . . . has fallen off. . . . In the second place, changes in the character of the demand due to technical progress have adversely affected certain of the industries entered in the table and benefited others omitted therefrom. . . . In the third place, certain of the industries which have developed most rapidly are omitted from the list considered. Among such may be mentioned the motor-car and rubber, and the boot and shoe industries.'

The advance in productivity during the first post-War decade, especially among industries producing raw materials, was even more remarkable than the change between the pre-War and the post-War periods, as the second table on p. 37 shows.

Although figures to show the labour and the capital engaged do not exist for most of the industries in question, one need have no hesitation in saying that the technical productivity of the raw-material-producing industries advanced enormously during the decade with which this chapter deals. That this was true also of the higher stages of production is illustrated in the following figures from Canada:

*Canadian Manufacturing Production**

	1901	*1911*	*1921*	*1925*	*1929*
No. employed (thousands) .	339	515	440	544	694
Capital ($ millions) . .	447	1,248	3,053	3,808	5,083
Value of products ($ millions)	481	1,166	2,517	2,949	4,064
Wholesale prices (1913 = 100)	84·5	95·0	171·8	160·3	149·3

* *Canada Year Book*, 1930.

Agricultural production cannot fairly be treated in the same way, since weather conditions in individual years may seriously disturb the trend. But it is interesting to note the following figures for Canada, who not only became the greatest source of supply of grain for importing countries after the War of 1914–18 but also greatly enlarged her exports of fruit, cheese, and other agricultural produce. Between the censuses of 1911 and 1921 the numbers employed in agriculture increased by 12 per cent., whereas the wheat crop increased by 72 per cent., the oats crop by 49 per cent., the

barley crop by 54 per cent., and the output of cheese and butter from factories and creameries by 10 per cent. In the following ten years the numbers employed in agriculture rose by less than 9 per cent., while the following increases of agricultural production were recorded: wheat, 42 per cent.; barley, 57 per cent.; and factory cheese and butter, 17 per cent. The oats crop was 10 per cent. less, but the weather conditions in 1931 were generally unfavourable.

The corollary on the consumer's side was naturally a rise in the standard of living. The advance in real wages is not sufficient evidence to prove the point, since it might possibly have been secured at the expense of other sections of the community; but the increased consumption of luxury goods, of which motor-cars may be taken as an example, shows that there was a growing surplus available after more urgent needs had been satisfied. Between 1924 and 1929 the number of cars in use in the world increased by 62 per cent. and the number of motor-cycles by 127 per cent. Another luxury which was being consumed in increasing quantities was the services of distributors. British statistics show, in the post-War period, an uninterrupted rise of the proportion of the total number employed who were engaged in transport and distribution. In 1923 the number of persons insured in the following trades, distribution, railways, road transport (other than tramways and omnibuses), canal, docks, and harbour service, and other transport, communication, and storage was 1,810,300. In 1929 it was 2,189,700, whereas the total number of insured persons had risen only from 11,485,800 to 12,094,000.[1] In the United States the numbers employed in factories actually declined by nearly 10 per cent. between 1919 and 1929, although the end of that period was marked by notable industrial prosperity. The output per factory worker was estimated to have increased by 45 per cent. over the same interval. Thus there is established, as one of the most important facts in post-War economic life, a tendency for goods, both in the raw and in the manufactured stages, to become relatively cheap, and for a greater and greater proportion of the world's wealth and energy to be devoted to

[1] The figures for 1929 exclude persons of 65 or over.

services, including transport, communication, banking and insurance, house-building, hotels, entertainments, and government.

The effects of such a tendency in international affairs must always be of the most profound importance. Greater and greater fluctuations in the price of raw produce—the effects of which on political relations have already been indicated—become possible without there ensuing any comparable disturbance to the economic structure of countries or localities principally devoted to the higher stages of manufacture and to services in the broad sense, and without the appearance of those counter-balancing changes in demand which in simple economies check upward or downward movements in the prices of commodities. On the other hand, as the proportion of aggregate human labour which must be devoted to the cultivation and extraction of primary products diminishes, the specialization of economic functions among the various countries, and the former forces influencing great movements of population from old to new lands, must tend to sink into the background. In face of monetary difficulties and the inelasticity of demand for raw products (the price of which in most cases represented but a small fraction of the cost of the goods into which they entered, as prepared and delivered for consumption) this increase of productive efficiency manifested itself in the semblance of over-production.

(*f*) *The Control of Prices and of Supply*

The term 'over-production' must not be given any absolute significance or it becomes meaningless, since there appears to be no proximate limit to the possible needs of the human race for the fruits of the earth. The expression means no more than the appearance on the market of a greater total output of some commodity than can be disposed of at a price remunerative to all the producers who had previously been able to cover their costs. Over-production of isolated commodities, whether raw stuff or manufactured articles, is of no special moment. Rapid technical advance, for instance, is likely to encourage the intervention of new producers fully able to take advantage of the improvements, while the old producers

remain in operation in the hope of better times, although they are forced below the margin of profitable business. There can be little doubt that this process was one of the chief causes of over-production in the first post-War decade. Over-production of isolated commodities is also especially likely to occur where the demand for a product is inelastic; that is to say, where, in order to market an output augmented by *x* per cent., the price has to be diminished by more than *x* per cent. It was probably true of wheat, for instance, that the greater the world crop the lower the total sum obtained for it by farmers. General over-production, on the other hand, or rather the lasting tendency to 'over-produce' a wide range of different goods, may be, and was during the period under review, the cause of wide international repercussions.

Clearly it would be hopeless to attempt, by organization of an individual industry, to intercept the effects of world-wide monetary conditions; much of the history of attempts to control prices or output since the War was a record of failure to comprehend that proposition. Attempts at such control were by no means unknown before 1914. They were distinguished, however, in the decade with which this chapter is concerned chiefly by their wide extent. Copper, tin, zinc, grain, cotton, jute, rubber, coal, diamonds, coffee, tea, sugar, and oil were among the commodities for which regulating plans were put forward and, in almost every instance, introduced.

These plans took a number of different forms, yet there was much in common in their origin, character, and experience. The extent of governmental co-operation was especially characteristic. The Stevenson rubber restriction scheme, the Federal Farm Board of the United States, the Brazilian coffee valorization schemes, and the Chilean nitrate reorganization were all instances of direct governmental action. A State Conservation Law was the first stage in oil restriction in America. The Netherlands Indian Government, though at this time they eschewed rubber restriction schemes, definitely lent their assistance to restriction in the tin industry. The Provincial Governments of the Canadian prairie provinces were soon implicated in the operations of the wheat pools,

and the Dominion Government itself could not hold aloof at the time of crisis.

A number of causes contributed to the failure of so many of the schemes, whether private or official. In several cases, notably rubber, nitrates, and the base metals, competition was felt from substitute commodities. Sometimes, as with coffee, direct regulation of prices led to an augmentation of supply. Usually the tale was one of the stimulation of alternative sources of supply by restriction in a limited area; this was an outstanding factor in connexion with Malayan rubber, Ceylon and Indian tea, and American copper and oil.

A further important obstacle was the inability directly to control the output of agricultural commodities. The supply of rubber was critically affected by the coming into bearing of trees that had been planted half a dozen years earlier. Coffee valorization broke down because the crops of 1927–8 and of 1929–30 were abnormally large; the difficulties of the Canadian wheat pools were traceable to the abundance of the 1928 harvest. But most important of all was the impotence of organized restriction, designed to affect the market for a single commodity, in face of a world-wide decline in prices affecting the whole range of commodities. Many of the earlier schemes weathered, though with difficulty, the deflation of 1922–9, but practically none stood up to the violent deflation of 1930. One of the most successful schemes, that for tea, was so partly because the restrictive process tended to enhance the average quality of the product, but partly also because the demand for tea was domestic and not industrial, and was therefore affected only indirectly by business depression.

Rubber.

Perhaps the most notable of all the post-War restriction schemes was that applied to rubber (the Stevenson scheme). Immediately after the War, when the industry was faced with the cessation of demand for military purposes and with an immensely stimulated capacity, restriction was practised voluntarily by the Rubber Growers' Association. These efforts failed to maintain prices for two main reasons: the weakness of demand for rubber for manufacture, owing to the

industrial slump and the development of the cord tyre, and the growth of competition from native growers, chiefly in Netherlands India. In 1921, in response to appeals from growers in the Malay States and Ceylon, the British Colonial Office appointed a Committee under the chairmanship of Sir James (later Lord) Stevenson to examine the whole position of the rubber-producing industry.

In their first report the Committee gave their opinion that no scheme of organization could be successfully carried out without the co-operation of the Netherlands Indian authorities. When, however, it transpired that their co-operation was not forthcoming, a second report was issued recommending that planters in the British Empire be legally prevented from exporting more than a stated percentage of a standard output, the percentage to be fixed at quarterly intervals according to the average price ruling for rubber during the previous quarter. The intention was to maintain the price at some figure between 1*s.* and 1*s.* 6*d.* per lb. This scheme was accepted by the British Government, and, after the passage of the necessary legislation in Malaya and Ceylon, was put into force on the 1st November 1922.

For some time the Stevenson scheme was successful. Until the middle of 1925 the quota varied between 50 and 65 per cent., and the price scarcely traversed the appointed margins. Then came a sudden and enormous rise of price. The obvious reason for that rise was the almost too great restriction in the British areas, while demand was rapidly increasing. The effect of restriction was a sharp shrinkage of stocks of rubber.

In those circumstances, a strong bull market in rubber developed, and the average price recorded in the quarter ending the 31st July 1925 for purposes of restriction was 3*s.* 2½*d.* per lb.; the exportable quota was promptly raised to 75 per cent. The price, however, continued to rise, and by the end of the year had exceeded 4*s.* per lb. The excitement was transferred to the Stock Exchange, where the market in rubber shares became feverishly active. The boom in existing securities was accompanied by the issue of many new shares and the flotation of new companies. Many representations were made to the Government that in the circumstances the

Stevenson scheme, subject as it was to heavy criticism by manufacturers, should be abandoned, but the official view was that the rise in price was merely temporary and that the scheme should continue.

In fact the seeds of collapse were being steadily sown by the scheme itself. In 1921 the British Empire had possessed 75 per cent. of the world's rubber production. In 1922 the percentage fell to 67 per cent., in spite of a large increase of British production, owing to the growth of native planting in Java and Sumatra. In 1924, under restriction, the British share of world production had fallen to 52 per cent. The new demand for rubber, where it was not met out of accumulated stocks, was being supplied by Dutch and native growers. Moreover, the high price for rubber was encouraging the use of reclaimed rubber as a substitute.

At this time, too, the operation of the scheme was causing unfortunate international bitterness. The United States consumed over two-thirds of the world's rubber supply, while controlling none of the major sources. When the price of rubber rose to the extravagant heights of the autumn of 1925, the dissatisfaction of American rubber users grew into outcry. A Committee of the United States Congress on the monopolization of important raw materials recommended the introduction of defensive legislation, but the Administration contented itself with a strongly worded protest against the 'unfairness' of the Stevenson scheme.

The boom in rubber prices did not last long. By June 1926 the spot price of smoked ribbed sheet in London had fallen to 1*s.* 8*d.* A number of forces contributed to this decline. The exportable percentage under the scheme had been raised successively to 85 per cent. and to 100 per cent. The quantity of reclaimed rubber produced in the United States had been rising year by year. It became apparent, in the first half of 1926, that the world demand for crude rubber was not keeping pace with the augmented supply.

Meanwhile, the exportable quota remained at 100 per cent. In June 1926, however, new regulations were promulgated, fixing the standard price at 1*s.* 9*d.* instead of 1*s.* 3*d.* By the middle of 1927, restriction was in full force again, with a 60

per cent. quota, but exports from British areas were greater than before the boom, owing to an increase of assessments and to the carrying forward of export rights. World demand remained slack, and in June 1927 the price slumped again to 1*s*. 4⅛*d*. Opposition to the scheme continued to grow. Apart from its other disadvantages, restriction was adding to the average costs of British producers. In November 1928, following an official investigation, the British Government brought the Stevenson scheme to an end.

Some of the effects of restriction are shown in the following table:

*Rubber Production and Consumption**

(1,000 tons)

Year	Production			Consumption			Production of reclaimed rubber in U.S.A.
	British areas	Other areas	Total	U.S.A.	Elsewhere	Total	
1920–2 (average)	255	100	355	227	105	332	54
1923 . .	214	168	382	310	115	425	69
1927 . .	297	307	604	370	210	580	174
1923–7 (average)	263	245	508	353	161	514	132

* *Rubber Quarterly*, Feb. 1928.

A comparison between the three years before restriction and the five years of its effective operation shows that the scheme did on the whole secure a balance between supply and demand, but entirely at the expense of the British producers. So far was restriction from stabilizing prices that, although the price was about the same at the end of the scheme as it had been at the beginning, it had risen in the meantime to over five times its initial level.

Wheat.

Before the War there existed in Western Canada several wheat-selling organizations managed by the farmers themselves; the most important were the United Grain Growers, operating in Manitoba and Alberta, and the Saskatchewan Co-operative Elevator Company, which had the direct

support of the Provincial Government. In 1923 the first co-operative wheat pool was formed in Alberta. In the following year pools were formed in Saskatchewan and Manitoba. The three pools formed a Central Selling Agency, responsible both for the general policy of the pools and exclusively for export policy. In 1925 Manitoba and Saskatchewan organized pools in the coarse grains, and these, too, were placed under the Central Selling Agency, but they remained of minor importance compared with the wheat pools. In the following year the Sasketchewan pool purchased the Co-operative Elevator Company, and the Manitoba and Alberta pools made an arrangement with the United Grain Growers which was a prelude to purchase. After the renewal of the contracts between the pools and their members in 1928, the pools controlled more than 55 per cent. of the crop. Attempts were made to link up with pools in other wheat-exporting countries.

The Canadian pools were faced before long with serious price problems. Although they had managed to pay \$1.46 on the 1927 crop, their carry-over into the next crop year was so substantial (about 20 million bushels), and the crop of 1928 promised to be so abundant, that they reduced the standard initial payment from \$1.00 to 85 cents. In the following year, in spite of enormous surpluses all over the world remaining from the bumper 1928 harvest, the pools saw fit to raise the initial payment to \$1.00 again, having regard to the poor Canadian crop and the very rapid advance in prices which had taken place in the summer. The optimism of the directors of the pools was not vindicated. During the early months of the crop year the principal European importers obtained by far the greater part of their supplies from Argentina, in defiance of the price-maintenance policy of the pools. In the New Year there was a sharp fall of prices.

A crisis rapidly developed in Canada. Although a final payment on the 1929 crop was due, all the funds of the pools were locked up in holding immense stocks of wheat. On the 15th February the Governments of the three prairie provinces announced that they would guarantee bank advances to the wheat pools to the extent of 15 per cent. above those already made. In August the newly returned Conservative Govern-

ment in Ottawa refused to give a federal guarantee for advances to the pools, the three Provincial Governments having decided that their commitments could not be increased. Thereupon the pools reduced the initial payment on the 1930 crop to 60 cents a bushel, but even this had subsequently to be reduced to 50 cents, for prices continued to fall. Disgruntled farmers pressed for legislation to free them from their contracts with the pools, whose cash payments were said to compare unfavourably with those secured through the Grain Exchange. A powerful movement was set on foot to establish a compulsory marketing board, but it found little favour in high places. The Federal Government offered to stand behind the banks should the price fall below 60 cents, in order that they should not be forced to liquidate stocks under mortgage.

Meanwhile, an attempt at stabilization was being pursued across the border. Under the Agricultural Marketing Act of June 1929 the United States Federal Farm Board was created with wide powers to check speculation, promote co-operative marketing, and control surpluses of agricultural commodities. A revolving fund of $500 millions was established to make loans to co-operative associations to help them in financing crops, or to stabilization corporations to assist them in maintaining prices. The Grain Stabilization Corporation was set up as the agency of the Federal Farm Board for wheat. In the autumn of 1929 the Board was making loans on wheat up to $1·25 per bushel on the finer grades in an attempt to keep back supplies from the market. In March 1930 it was announced that the Grain Stabilization Corporation, with the Board's backing, would purchase wheat in order to hold up prices to what was held to be an economic level. The further slump in prices left the Corporation holding, with the aid of Government money, many million bushels of wheat that it was unable to market. The Federal Farm Board insisted that price maintenance would be impossible without restriction of output, and recommended wheat growers to reduce their acreage by 10 per cent. Widespread opposition was being raised to the operation of the Board and of the Grain Stabilization Corporation, notably by the United States Chamber of Commerce.

Tin.

On the 11th July 1929, at a meeting of directors and delegates of tin-producing companies held in London, the Tin Producers' Association was formed. The Association at first was representative only of British interests. The statistical position which it had to face is summarized in the following figures:

*World Tin Output**

(In thousands of tons)

	1926	*1927*	*1928*	*1929*
F.M.S. Non-Chinese	20·2	21·4	30·2	40·9
Chinese	25·7	30·8	31·7	26·1
Netherlands India	33·0	33·9	34·9	35·0
Other Eastern Countries	19·7	19·4	20·5	23·1
Nigeria	7·4	8·1	9·1	10·4
Bolivia	30·1	35·8	41·4	43·0
Others	8·8	9·1	9·1	9·2
World total	144·9	158·5	176·9	187·7
Average price per ton	£291	£289	£227	£204

* Source: Tin Producers' Association.

Estimates made by the Anglo-Oriental Mining Corporation showed that production of tin outran consumption by 6,627 tons in 1928 and by 6,486 tons in 1929, and the existence of these unabsorbed surpluses was, of course, reflected in the decline of price.

In October 1929, by which time the price had fallen to £176 a ton, a meeting of the Association unanimously approved a scheme for the regulation of supplies of tin, and the Council was authorized to put it into effect. The scheme provided for the holding up of tin ore at the smelting works in accordance with the conditions of the market for the metal. It never came into operation. Two months later a new scheme was introduced, providing for the direct limitation of output by means of the stoppage of work at week-ends and during one whole week per month in January and February. At about the same time a holding company was formed to acquire the shares of four out of the five chief tin-smelting firms of the world.

In January 1930 the two great tin-mining and tin-smelting groups in Bolivia, the Patino group and the Aramayo Mines, controlled by the Guggenheim interests, joined the Association. It was announced that 75 per cent. of the Nigerian producers were already carrying out the restrictive policy, and that 69 out of 105 dredgers in Malaya were closing on Sundays. In March 1930, with the authority of the Netherlands Indian Government, the two great Dutch concerns, the Banka and Billiton companies, agreed that the output of neither should exceed 1929 production. In April 1930 the Tin Producers' Association stated that producers with a normal output of 140,994 tons a year were agreeing to restriction, to the tune of 26,739 tons a year. They admitted, however, that producers with a normal capacity of 50,028 tons had not agreed to restrict.

A further change in the basis of restriction was made in April 1930, when a meeting of the Association unanimously agreed upon principles designed to secure that all plants should directly restrict their output to 80 per cent. of normal. The Nigerian Council of the Association had adopted a tonnage basis of restriction earlier in the year, and direct restriction of output had been employed at the accession of the Bolivian and Netherlands Indian groups. In spite of its success in securing the co-operation of these important sections, the Tin Producers' Association was forced to reconsider its restriction policy in the summer of 1930, in view of the curtailment of United States consumption and the consequent growth of visible supplies. By June the price in London had fallen to £140 a ton.

The Association recommended to its members complete cessation of production for two months (July and August). That was duly carried out and had a considerable effect on stocks of tin; nevertheless, prices continued to be weak, and before 1930 was out they had sunk to little over £100 a ton. The 20 per cent. restriction policy was continued after the two months' stoppage, but consumption was not being stimulated by low prices, and restriction had done scarcely more than remove that proportion of production which would have been surplus to requirements even in a normal period. By this

time a more powerful restrictive force than voluntary agreement was coming into play, namely, the pressure of low prices on high-cost producers. Bolivian mines especially were incurring losses and were being forced to shut down their most uneconomical plant; meanwhile Malayan companies with costs down to £100 a ton were becoming restive under a policy which kept the more costly mines going at the expense of the more efficient.

(g) *Conclusion*

In this chapter attempts to control production and prices have been deliberately singled out for more detailed description than space permits to other pieces of post-War economic history. A few concluding words are needed to fit those attempts into the general framework of post-War economic tendencies.

The end of the Great War found the world's economic life utterly disorganized. Some industries—notably shipping, coal-mining, iron and steel, and heavy engineering—had been expanded far beyond the needs of peace-time. The whole economic life of Russia was reoriented and regimented in a manner quite unknown to the pre-War world. Currency standards were deranged, monetary gold resources were ill distributed, and the purchasing power even of gold-standard currencies greatly diminished. War-time extravagance, ambitious social legislation, and above all the heavy weight of national debts, both internal and external, forced upon European countries a continuance of the unbalanced budgets, the borrowing and the inflation by means of which they had carried on the War.

The boom of 1919 and the collapse that began in the following year and spent its strength in 1921 were symptomatic of that maladjustment. Indeed, the economic history of the whole of the first post-War decade is a tale of attempts to meet or to defy the disorders that the War had wrought in the world's economic system. By the end of the decade those disorders were far from having been eradicated, but reparations and inter-Ally war debts had been funded, no important European currency save the Spanish peseta remained to be

stabilized, and the slump of 1930 was causing new economic problems to obscure the old.

'Over-production' was characteristic of the decade with which this chapter has been concerned. It was partly due to the existence in some industries of productive capacity, both in labour and in capital, which was needed in war-time but not in peace. In that form it presented a problem of eliminating, whether by organized schemes or by the painful process of competition, the least economical resources of men and plant and of finding other productive employment for them. In part, over-production was caused by rapid changes in demand and in technical processes—for instance, the substitution of oil for coal, or of artificial silk for cotton and light fabrics for heavy, or the increase of silver production as a by-product of base-metal smelting; in part by an all-round enhancement of productivity which increased the output of raw produce at a pace higher than that at which demand for it was expanding, in view of the tendency to spend surplus income on services rather than on commodities. Here, again, the problem was mainly to diminish and redirect resources of individual industries. But from time to time, and especially as the decade closed, over-production also took the form of an almost universal difference between available supply and expected demand, applying at the same time to a very wide and inclusive range of commodities, both at the raw and at manufactured stages of production. To put it very roughly, inflation had artificially stimulated the supply and deflation had artificially contracted the demand.

Failure to realize the nature of the underlying problems accounted for much of the want of success met by schemes to alleviate over-production. 'Rationalization' was frequently regarded as aiming, by way of enhanced competitive power, at the employment of all the labour available for some industry possessing excess capacity, rather than at eliminating the least efficient capacity in both man-power and machinery. Deflation was sometimes accused of causing unemployment which patently resulted from the existence in certain industries of productive power in excess of world demand. On the other hand, expedients for the regulation of production or

prices in an individual industry were often, as has been recorded above, resorted to in face of conditions which applied to all industries alike.

Economic nationalism was an important aspect of the attempts to meet over-production and economic dislocation. Reservation of home markets or artificial stimulation of exports appeared, to many people, to be a remedy for local over-production. More often, it was the artificial support of alternative industries that was proposed as a means of absorbing the labour thrown out of employment in the industries with excess capacity. Other causes of economic nationalism have been suggested earlier in this chapter. Restriction of output as a means of maintaining price was another much-used device for coping with conditions of over-production. Its importance in the post-War years lies in the great increase of its scope and in the growing willingness of Governments to encourage it and to take part in it. That willingness was symptomatic of increasing interference of Governments with industry and trade by other means than tariffs. Social and factory legislation was pressed forward all over the world. Governments took it upon themselves to finance international trade and to make loans on easy terms to certain classes of enterprise. The part that might be played by Governments in assisting industry by such means as publishing statistics, fixing standards, and sending trade representatives abroad was more fully realized. Meanwhile the international character of the economic problem was, if neglected by comparison, at any rate not so far forgotten as it had been before the War

II

THE SLUMP, 1929–31

TO open the tale of the world depression with the stock-market crash in New York in October 1929 is like starting the story of a flood at the moment when the last sod in the dyke gave way. The boom of 1928–9 concealed underlying deflationary tendencies, and its collapse merely allowed these to exercise their forces unchecked. The fall in commodity prices, as the previous chapter has shown, proceeded with only intermittent relief from 1925 onwards. Already in the first half of 1929 the pressure upon debtor countries to sell at cut prices had been grievously enhanced by the reduction of British and American lending.

The boom, then, did not take the form of an inflation of commodity prices. Nor was there even any striking enlargement of industrial production in the United States. On the base 1926 = 100, the American production index for 1928 was 103 and that for 1929 was 110, while the peak figure was only 116. Still less did the boom involve a great increase of factory employment in America; for the annual index was the same in 1929 as in 1926, and even the most favourable monthly figure, after allowing for seasonal variations, was only two points higher. The character of such industrial expansion as there was is also important. The only large groups of industries in the United States in which 1929 employment exceeded the average of 1926 were machinery, paper and printing, chemicals, and rubber products; even in the transportation equipment group the increase in automobile manufacture was more than offset by the decline in railway-carriage building and repair.

The boom in the United States may be described as an increase of 'real investment' beyond the current rate of saving, providing a volume of purchasing power which found its way primarily into the stock market and real-estate market, and secondarily into the purchase of highly manufactured goods and, even more notably, of services, including entertainments, transport, and retail trade. Like all big inflationary or deflationary movements, it was naturally cumulative; for the

widening market for finished goods and services increased the profits of the industries providing them, and so drove up security prices still farther. When the boom collapsed the sequence was reversed, though the speculative mania had become so intense that the reduction of public purchasing power through the falling off of capital construction did not affect stock prices until it had clearly brought about a curtailment of manufacturing employment and output. On the base of 1923–5 = 100, the index of building contracts[1] reached a maximum (after allowing for seasonal variations) of 139 in June 1928; a year later the adjusted index was only 126. At that date (June 1929) the adjusted indices of industrial production, of factory employment, and of freight-car loadings all reached their highest points. The prices of share securities, however, continued to rise on Wall Street, the monthly average index touching, in September 1929, a maximum height 125 per cent. above the 1926 level. On the 24th October, after a short period of orderly liquidation, there was a panic in the stock market: the balloon had burst at last.

These figures show clearly that the stock-market crash was preceded by an industrial recession, itself a year behind the curtailment of capital construction. In the end these factors were bound to prevail, but there were also international reasons why the stock-market inflation could no longer be maintained. The first was the growing stringency of world credit conditions. London in particular was hard pressed by the effort at once to encash foreign deposits and to finance the borrowers who could no longer apply to New York, even while British funds were themselves being sucked into the Wall Street vortex. On the 26th September 1929 the Bank of England rate was raised from 5½ per cent. to 6½ per cent. The collapse and exposure of over-speculative or fraudulent concerns, which was so obvious and so painfully purgative a symptom of the world economic crisis,[2] was early exemplified

[1] A three months' moving average centred at the middle month.

[2] Many other instances might be cited, from the 'Favag' and Katzenellenbogen cases in Germany and the Oustric failure in France to the Insull receivership (Middle West Utilities) and the Kreuger collapse. As His Holiness the Pope said in the Encyclical 'Caritate Christi Compulsi', 'even the very few who have in their hands enormous wealth, together with the destinies of the

in the Hatry affair in London in September 1929. The second reason was the exertions of the debtor countries to compensate the curtailment of international lending by enlarging their export balances. These efforts not only assisted the collapse of world prices but also bore directly upon the economic difficulties of the United States.

The slump, once started, continued a swift and snowball career. Perhaps the most significant fact on the American side is that the index of factory pay-rolls fell by 16 per cent. in three months. The great contraction of purchasing power which this indicates was hardly compatible with any permanent improvement of internal prices and commercial conditions. There was, indeed, a trade revival early in 1930. Stock prices rose sharply, industrial production and capital construction—under the stimulus of official policy which had later to be reversed when the budgetary problem became critical—advanced by more than the normal seasonal increase; but in face of world conditions the improvement was bound to be short-lived, and by May all the indices were dropping again. It might have been expected that, just as the American boom had no striking effect in stimulating world prosperity, so its collapse would have had equally little influence on the advance of the world depression. But that would have been a false deduction. Not only did the decline of the American industrial market force down the prices of such 'key' commodities as tin and rubber; the whole financial system of the world had received a shock from which it would need time to recover. Every stock market declined in sympathy with Wall Street, and liquidation both local and international was the order of the day. The inflow of gold to London and the reduction of the Bank of England rate, while they relieved a tense financial strain, did not do much to stimulate enterprise and capital construction. The abrupt curtailment of international lending—however wasteful and unjustifiable some of the previous loans may have been—had dislocated world trade and depressed commodity prices. The collapse of the

world, and who with their speculations were responsible for so much of our woe, are themselves often the first and most notorious of the victims, dragging into the abyss the fortunes of others'.

stock-market boom did not, however, liberate for foreign investment the full resources that the boom itself had imprisoned; for private investors, having frequently squandered their capital gains or pledged in instalment payments hypothetical future incomes, were constrained to economize rather than to invest, while the bond houses were too much preoccupied with disposing of their 'undigested' stocks of former flotations to be interested in new ones. On the borrowers' side the fall of prices that had already taken place had gravely injured their economic status. Forced to achieve a larger outward balance of trade, they had either to export a greater and greater quantity of goods, or precipitately to curtail their imports, in order to maintain their balance even at its former level. The combination of diffident or harassed lenders and weak or even bankrupt borrowers automatically prevented any revival of international lending on the scale of earlier years.

Moreover, faced with financial stringency, with rising stocks and shrinking markets, scheme after scheme for the artificial regulation of prices fell to the ground.[1] The next phase, then, of the economic depression, after the collapse of stock-exchange inflation, was the world-wide acceleration of the fall of prices. During 1930 (January to January) the monthly average index of wholesale prices fell in Great Britain by 18 per cent., in the United States by 16 per cent., in France by 6 per cent., in Germany by 13 per cent., in Italy by 18 per cent., in the Netherlands by 20 per cent., and in Japan by 21 per cent.[2] The difference between the various national figures is due in part to the variation of the schedules of commodities included and in part to the effects of tariffs and other measures of protection. The fall of prices was not evenly spread between the various groups of goods. National experience in this respect differed, but in general the prices of raw produce fell more rapidly than those of goods at the later stages of manufacture, a fact which temporarily assisted industrial countries like

[1] See above, pp. 40–50.

[2] Sources for wholesale price indices: Great Britain, Board of Trade; U.S.A., Bureau of Labor; France, Statistique Générale; Italy, Istituto Centrale di Statistica; Netherlands, Centraal Bureau voor de Statistik; Japan, Bank of Japan.

Great Britain but which could not do so for long, since their markets abroad were being concurrently impoverished.

A further commentary on the same aspect of the depression is provided by the course of cost-of-living and retail price indices. In Great Britain, for instance, the cost-of-living index fell by only 8 per cent. in 1930 and in Germany by the same amount. The widening margin between wholesale and retail price indices grievously exercised politicians and publicists, although it was a normal accompaniment of a price depression and reflected much more the inflexibility of internal manufacturing and distributing costs, including wages, than any abnormal profits reaped by traders. In France the cost of living (Paris index) was actually rising while wholesale prices were falling, a fact which not merely diminished her competitive ability in international markets but was also the origin of a series of labour troubles. Protection and the inflow of gold were having, though slowly, the consequences that the classical economists attributed to them.

The effect of the world-wide fall of prices on industrial conditions is too familiar to need detailed treatment. The purchasing power of raw-material producing countries was enormously diminished. Markets contracted, profits fell, production was curtailed, buying of stocks was restricted, and prices dropped still further. Because the money rewards of the various sections of the community were adjusted to the new levels of prices at varying speeds, the distribution of the aggregate product of industry and agriculture was fundamentally altered. Out of a diminishing volume of goods and services, wage-earners and salary-earners in employment, together with pensioners of all kinds and creditors for fixed interest, became entitled to a larger and larger absolute amount as the purchasing power of their money rose. Hence the residuary margin for profits steadily declined and enterprise was utterly discouraged. In 1930 wage rates in Great Britain fell by only ½ per cent.,[1] whereas industrial profits fell by roughly 16 per cent.[2] As profits declined and markets shrank, production was diminished and stock-market prices, based on profits, continued to slide. Despite a revival in the

[1] Ministry of Labour index.

[2] According to the *Economist*.

first five months of the year, industrial production fell during 1930 (January–January) by 21 per cent. in the United States, and in Great Britain by 14 per cent. (first quarter-first quarter).[1] On the New York market the average price of common stocks fell on balance by 28 per cent. between January 1930 and January 1931.[2] In London, where the earlier rise was much less, the drop was more moderate also, amounting to only 19 per cent. in the year. The difference between the two markets was due partly to the fact that during the boom stock-exchange prices had undoubtedly been inflated in New York beyond their real value on the basis of earnings, partly to the more adventurous methods of financing adopted by American companies, especially during 1928 and 1929; but partly also to a difference in business sentiment. Great Britain, accustomed for years to a heavy volume of unemployment, to adversities of export trade, and to other symptoms of economic disorder, took further troubles phlegmatically, whereas the United States, deluded by promises of continued and advancing prosperity, still looked for a revival round the corner, and, finding none, relapsed into despair and occasionally into panic. In spite of the shocks suffered by London in the summer of 1931, the difference became more and more pronounced as time went on.

The fall in stock-exchange values was naturally reflected in the new issues markets, the chief features of which are shown in the table on p. 59.

The chief points of interest in these figures are the great rise of American domestic issues in 1929 and their equally sudden fall in 1930; the revival of international lending in both countries after the collapse of the Wall Street boom—insufficient, however, to bring the 1930 figures up to three-quarters of their 1928 level; and the striking preference shown, as prospects darkened and profits fell, for debentures and notes in place of securities carrying the equity. The sluggishness of the capital market defied the stimulation afforded by cheap money. By

[1] Sources for production indices: U.S.A., Federal Reserve Board; Great Britain, Board of Trade.

[2] Sources for security indices: U.S.A., Standard Statistics; Great Britain, *Bankers' Magazine*.

New Capital Issues

Country	*Year*	*Total*	*Domestic*	*Foreign*	*Debt*	*Share capital*
		(In £ millions)			*Per cent.*	*Per cent.*
United Kingdom[1]	1928	362	219	143	26·0	74·0
	1929	253	159	94	22·5	77·5
	1930	336	127	109	43·6	56·4
		(In $ millions)				
U.S.A. . .	1928	8,040	6,789	1,251	44·6	55·4
	1929	10,091	9,420	671	26·0	74·0
	1930	6,909	6,004	905	66·5	33·5

the end of 1930 the New York Federal Reserve Bank rate was 2 per cent., whereas at the time of the stock-market collapse it had been 6 per cent. The Bank of England rate had likewise been reduced from 6½ to 3½ per cent., and the open-market rate had fallen still more steeply. All the great financial markets shared in this easing of credit conditions, Paris the least, proportionately, and Amsterdam the most. But all to little avail. The shock to confidence had been too great and the circumstances of potential borrowers were too doubtful for the easy-money leaven to penetrate far beyond the short-term market, where, indeed, it partly resulted from the decline of trade and hence of paper for re-discount.

The fluctuations in international lending, the embarrassments of debtor countries, the fall in prices, the depressed conditions in the creditor countries, all naturally had a profound effect upon the volume and distribution of world trade. Indeed, it is impossible to establish any clear chain of cause and effect among these various factors. The table on p. 60 has been compiled so as to bring out certain vital aspects of the world-trade upset.

The chief countries omitted from this table are China, a number of the smaller Latin-American States, and the dependencies of European Powers. Apart from such omissions, the discrepancy between aggregate exports and aggregate imports arises mainly (though not exclusively) from the fact that the former, for the most part, are valued f.o.b. and the latter c.i.f.; hence imports into country A from country B

[1] Excluding British Government issues.

International Trade, 1928–30

(In £ millions)

	Year	Imports for domestic consumption	Exports of domestic produce	Balance
Twenty debtor countries (a) .	1928	2,255	2,156	−99
	1929	2,232	2,214	−18
	1930	1,763	1,787	+24
Six creditor countries (b) .	1928	2,858	2,600	−258
	1929	3,010	2,619	−391
	1930	2,501	2,054	−447
World (33 countries) (c) .	1928	6,005	5,521	−484
	1929	6,136	5,575	−561
	1930	5,013	4,456	−557

(*a*) Argentina, Australia, Austria, Brazil, Chile, Czechoslovakia, Egypt, Germany, Greece, Hungary, India, Japan, Jugoslavia, Mexico, New Zealand, Peru, Poland, Rumania, South Africa, U.S.S.R.

(*b*) Belgium, France, Netherlands, Switzerland, United Kingdom, U.S.A.

(*c*) The above together with Canada, Denmark, Irish Free State, Italy, Norway, Spain, Sweden.

exceeds exports from B to A by all transhipment costs. The first point that emerges from the table is the rise in the value of world trade in 1929 and its decline in 1930 to a level considerably below that of 1928. The latter movement was, of course, largely the consequence of the fall of prices meanwhile, but it was not so entirely. If a correction is made for price changes, on the basis of an index averaging the wholesale price indices of ten representative countries,[1] the volume of trade for the 33 countries may be represented as 100, 104, and 97 respectively in the three years beginning with 1928. This result is borne out by such figures as are available of the bulk of international trade, indices of the tonnage entering into the external trade of seventeen countries being 100, 106, and 98 for three years. Crude indices of this kind can give only a very general picture of the course of world trade, but they are enough to indicate that whereas the decline in volume in 1930 was substantial it was not comparable with the devastating reduction that occurred in 1931.

[1] Australia, Canada, Denmark, France, Germany, India, Italy, Netherlands, United Kingdom, U.S.A. The resultant price indices, on the base 1913 = 100, actually were 144·7, 141·7, and 122·4.

More striking, and more important because of its bearing on the causes and character of the slump, is the contrast shown between debtor and creditor countries. In the space of two years the former group gained £123 millions in the balance of exports against imports, whereas the latter group lost £189 millions in the balance. It is important to note that this movement, which was, of course, associated with the curtailment of international lending, was already under way during the boom year 1929. In 1931 it was intensified still further.

The social changes effected by the world slump, which in their turn inevitably gave rise to political upheavals both pacific and revolutionary, can only be very briefly indicated. Vast fortunes, according to their nature, ebbed away or disappeared in the space of a few days. In the early phases of the depression the profit-taking class, and especially those whose riches were the fruit of speculation, suffered the most severely. The evaporation of the 'get-rich-quick' craze, and the exposure of the hollowness of some of the paper fortunes that had been built up during the boom, may be set on the credit side of the slump's gloomy balance-sheet. In so far as they were not also profit-takers, the rentier class benefited by the fall of prices without suffering any curtailment of their money incomes, though in the later phases of the slump national and private bankruptcies cut down the total of interest paid on bonded indebtedness. Nor did the incomes of salary- and wage-earners fall as swiftly as prices; but, regarded as a class, they bore much of the burden of the depression in the shape of unemployment. In the United States the percentage of trade unionists unemployed rose from 12·5 in January 1930 to 19·8 a year later; at the end of 1931, when the percentage was 21·8, the American Federation of Labor reported that there were 8,300,000 unemployed in the United States, and on this basis the figures given above would indicate a rise from 4,750,000 to 7,500,000 during 1930, though it is probable that the rise was steeper in the categories not included in the returns. In Great Britain the number of registered unemployed (including temporarily stopped) rose from 1,520,000 to 2,660,000 during 1930; in Germany from

3,220,000 to 4,890,000, after a seasonal relief in the summer; and in Italy from 490,000 to 750,000, also after a temporary improvement. In France the number on the live register, after showing little change for three-quarters of the year, suddenly increased, and at the end of January 1931, at 45,000, was 30,000 more than a year previously; when the figure was 50,000, in April 1931, a correspondent of the *Economist*[1] reckoned that 914,000 was the total to be compared with British official figures, and this would indicate a rise from 450,000 to 850,000 in the course of 1930. Thus in these five great countries alone, during those twelve months, over 6 million men and women were thrown out of employment. The political problems implicit in this fact were no less important than the financial. By far the most important political by-product was the growth of extremism in Germany, which eventually brought about the National Socialist revolution and all that has sprung from it.

The figures given so far in this chapter have related to the year 1930. That is convenient statistically, but it is misleading if it suggests that economic events wait upon the calendar or that a new phase of the world depression began on the 1st January 1931. The second part of the depression, the financial crisis as contrasted with the commercial slump out of which it arose, may be reckoned to have begun with the collapse of the Credit-Anstalt in May 1931. During the first five months of that year the general symptoms of the depression remained the same as they had been through the greater part of 1930. Wholesale prices fell by, roughly, another 5 per cent. (9 per cent. in the United States). Retail prices began to make up some of the lag; in Great Britain, where the wholesale food price index was virtually unaltered between January and June 1931, retail food prices fell by 8 per cent., but some part of the difference is to be explained by seasonal variations. In the United States the adjusted index of industrial production rose, between January and May, from 82 per cent. to 89 per cent. of the 1923–5 average, but in Great Britain and in most other countries except Germany there was a further fall both in the first and in the second quarters of the year. Employ-

[1] Issue of the 8th Aug. 1931, p. 288.

ment likewise showed no more than a seasonal improvement. Prices of share securities, after a rally in March, continued their descent in every market, and in the United States fell below the average of 1926 for the first time since the boom. Bond prices, however, remained at a high level until the financial crisis of the summer sent them upon the same sorry career as the more speculative counters. It was against such a steadily darkening background that the fresh crisis occurred.

III

THE CRISIS, 1931

(a) *Banking Collapse in Austria and Germany*

THE battery of circumstances against monetary standards in 1931 was not a sustained bombardment but a series of explosions, each of which lit the fuse for the next. The first threatening report sounded from Austria. To the collapse of the Credit-Anstalt is traceable the whole sequence of monetary crises that unhappily enlivened 1931. The Credit-Anstalt, founded in 1855 by the Rothschilds and ever since associated with that family, was easily the largest bank in Austria. Its assets and liabilities amounted to 70 per cent. of the total for all Austrian banks put together. Domestic and technical reasons were partly responsible for the embarrassment of the Credit-Anstalt, but a fuller explanation is to be found in the dismemberment of the Austro-Hungarian Empire in the Treaties of Peace, which deprived the bank of its source of capital and strength, exposed it to the nationalistic jealousies of the successor states, forced it to rely on foreign funds in financing a precarious economic system in Central Europe, and left it, like Vienna itself, too large and pretentious for the territory it had to serve. On top of this came the severe stock-exchange and trade slump of 1930–1. The Credit-Anstalt, whose balance-sheet at the 31st December 1930 already showed 'divers losses' (mostly depreciation of share holdings) amounting to 148 million schillings, against a share capital and reserve of 177 million schillings, could stand the strain no longer.

It was in the second week of May that the Credit-Anstalt's difficulties became publicly known. The Austrian National Bank, the House of Rothschild, and the Austrian Government came to the rescue with fresh funds, the Government subscribing 100 million schillings for shares in the bank. For a while the situation was relieved, but confidence had received a bad shock, and calls upon the Credit-Anstalt persisted in great volume all through May. Difficulties were enhanced by

the lack of working capital to keep alive the industrial enterprises in which the bank was interested. The Credit-Anstalt's troubles were also bound up with those of the Amstelbank, which was likewise associated with the Rothschilds, and which held a large proportion of the Credit-Anstalt's foreign assets.

Events now moved swiftly. An international committee of creditors was formed. On the 28th May the Austrian Parliament passed a bill authorizing the Government to guarantee any credits and advances granted to the Credit-Anstalt thereafter until June 1933. On the following day the Bank for International Settlements announced that, in association with ten leading central banks, it had agreed to grant a credit in foreign currency to the Credit-Anstalt. This support stemmed, for the time being, the run on the banks and the demand for foreign exchange by the Austrian public. By the 1st June the Austrian National Bank had taken over bills endorsed by the Credit-Anstalt to the tune of 400 million schillings (£12 millions); these discounts carried the guarantee of the Federal Government, which, with its other commitments, was sinking into much the same position of financial weakness as the Credit-Anstalt had itself occupied. The Austrian Chancellor made efforts to raise a loan in Paris, but—according to contemporary reports—it was impossible for him to accept the political conditions laid down, relating to the proposed Austro-German customs union. On the 16th June, however, the Bank of England made an interim advance of 150 million schillings (£4,300,000) to the Austrian National Bank, 'pending the completion of negotiations for an international loan to the Austrian Government', to provide it with funds for guaranteeing the foreign liabilities of the Credit-Anstalt. This action, while it probably saved Austria, in the nick of time, from complete financial collapse, contributed its quota to the subsequent difficulties of the London market. A few hours previously the Austrian Government had been forced to resign over the question of guaranteeing the Credit-Anstalt's foreign liabilities.

The new Government, aided by the Bank of England advance, guaranteed not only the liabilities of the Credit-Anstalt to foreign creditors (who for their part agreed not to press their

claims for a period of two years), but also all sums deposited on current account with the bank, together with savings accounts. Measures were passed enabling the Government to control the affairs of the bank, whose management was superseded. Salaries and pensions were reduced, and some 500 employees dismissed. Representatives of foreign creditors took part in the reorganization.

Meanwhile, however, the centre of disturbance had shifted to Germany. The Credit-Anstalt had been heavily indebted to foreign countries, and it was therefore not surprising that the infection of its disorders should have rapidly spread. The total foreign obligations of the bank were reckoned at $76 millions, of which $27 millions was owing to Great Britain, and $24 millions to the United States, the other chief creditor countries being, in fairly equal proportions, France, Holland, Switzerland, and Germany. But it was not the absolute amounts of these debts, large as they were, that mattered in determining the progress of the crisis. An individual bank, or the banking system of a country, has to remain liquid or perish. If one item among its assets, which had been regarded as liquid, becomes unrealizable for the time being, it must improve its proportion of liquidity by realizing other assets. The failure of the Credit-Anstalt involved a complete loss of confidence in Austrian finance, and therefore a 'standstill' upon all banking assets held in Austria. In order to cover their position, banks were forced to encash other foreign balances, and this movement was encouraged and enhanced by the depletion of public confidence in Central Europe. If Austria had failed, who, asked international investors, might not fail next? This beggar-my-neighbour struggle to maintain international banking liquidity, as one country after another 'froze' its foreign indebtedness, played an essential part in determining the course and the violence of the 1931 crisis.

It was natural that the attempt to liquidate foreign assets should have seized upon Germany as its next victim. Her financial houses were closely associated with those of Austria and of Hungary, who was also meeting with economic difficulties. Unprecedented sums had been invested in Germany by foreigners within the space of a few years, both at short term

and at long term. Her obligation to pay reparations, at a time when commodity prices were low and were still falling, and when the inflow of capital had been completely stopped, caused her creditors grave uneasiness. A number of important financial failures had already occurred. Heavy sales of German securities, largely on United States account, began in May and continued into June; foreign short-term capital was also being withdrawn. In spite of the sale of foreign exchange by the Reichsbank, the reichsmark became very weak and gold was exported. In the first week of June the Reichsbank lost Rm.180 millions in gold and devisen, and in the following week Rm.540 millions. When the Reichsbank tried to stem the tide by raising its discount rate from 5 to 7 per cent., the demand for foreign exchange was, if anything, accelerated. In such times, when possibilities of capital loss or gain far outweigh considerations of the rate of interest earned, not only is the ordinary instrument of discount policy often ineffective; it may well have the opposite result from that intended.

Internal political troubles also played their part in the German crisis. In the Reichstag elections of the previous year the National Socialists had obtained 107 seats, and both they and the Communists were now pressing for the immediate summoning of the Reichstag. Foreign creditors were awakening to the dangers of the political situation, and on the 19th and 20th June panic reigned among them. In a day and a half the Reichsbank lost Rm.150 millions of its gold and foreign exchange, and the cover for the note circulation fell almost to the legal minimum. In a last desperate attempt to control credit, private quotations were suspended, but unless there were to be some striking political intervention, nothing short of a general moratorium on foreign debts, coupled with exchange control, could have saved the German financial system from immediate collapse. On the evening of the 20th June, President Hoover proposed a year's moratorium on all inter-governmental debts arising out of the War, including reparations.

The relief with which that proposal was received in Germany was a tribute to its value in saving the whole Central European credit system from disaster. Panic was stayed in the financial markets of Berlin and stock could be taken of the

position. In the three weeks ended the 23rd June the Reichsbank had lost Rm.979 millions from its gold reserve and Rm.93 millions from its reserve of foreign currencies. Its holding of bills had risen by Rm.534 millions, while the note circulation had been cut down by Rm.573 millions. The Reichsbank's position was very weak, in view of the possibility of heavy demands to carry over the end of the month. In these circumstances, a credit was arranged jointly with the Bank for International Settlements, the Bank of England, the Banque de France, and the Federal Reserve Bank of New York, each of which undertook to rediscount the equivalent of \$25 millions of Reichsbank bills. It is significant that this \$100 millions credit was originally arranged as a purely temporary measure to obviate excessive strain on the Reichsbank from end-of-the-month demands, and was due to expire on the 16th July, whereas circumstances utterly prevented its withdrawal, none being repaid until March 1932, when 10 per cent. was paid off. In fact the credit was rapidly drawn upon and the Reichsbank began to lose exchange again before the end of June. The delay in the ratification of the Hoover Plan—the Laval-Mellon conversations did not reach a successful end until the 6th July[1]—was spoiling the confidence of foreign investors in Germany.

By that time another threat to Germany's economy had appeared. On the 3rd July it became known that the Norddeutsche Wollkämmerei (North German Wool Combing Corporation), commonly known as the Nordwolle, one of the largest industrial concerns in Germany, was insolvent. The failure was attributed largely to the bankruptcy of the Dutch subsidiary Ultramare; originally, the losses of both the principal and the subsidiary companies were mainly due to disastrous speculation in stock exchange securities. The interaction of failures in the stock market, in industry and in banking, was one of the most striking characteristics of the 1931 crisis. English banks were implicated in the Nordwolle failure, their claims totalling Rm.27 millions (£1·3 million), but the chief creditors were the Darmstädter und Nationalbank—commonly called the Danat—and the Dresdner Bank, which

[1] See below, p. 138.

were owed Rm.35 millions and Rm.25 millions respectively. Other large creditors were the Commerzbank (Rm.10 millions), the Deutsche Bank und Diskontogesellschaft—the so-called 'DD' bank—(Rm.9 millions) and the Schroeder-Bank of Bremen (Rm.9 millions).

This failure altered the character of the German foreign exchange crisis. Hitherto, the demand for gold and exchange had originated almost exclusively with foreign creditors who wished to repatriate their funds either because of their own banking difficulties or because they were losing confidence in Germany as a field of investment. Now, when big German banks were faced with heavy losses, the German public itself began to lose faith, and a flight from the mark supervened. On the 9th and 10th July alone the Reichsbank had to provide Rm.100 millions of exchange. Dr. Luther, the President of the Reichsbank, travelled with frantic haste from capital to capital, seeking to raise a new loan, but in vain. His very zeal perturbed both foreign investors and his own countrymen. On Monday, the 13th July, the authorities of the Bank for International Settlements, after conferring with Dr. Luther, issued a generally worded *communiqué*, offering their collaboration with the central banks in strengthening the assistance given to Germany by all the means at their disposal.

But this vague offer of help came too late. On that same day the Danatbank, one of the German 'Big Four', had closed its doors. The total liabilities of the bank were estimated at Rm.1,500 millions (£75 millions), of which about Rm.460 millions were owed abroad. The Danatbank had already lost about Rm.1,000 millions of deposits, most of them on foreign account; its losses in the Nordwolle collapse have already been mentioned. When the Danatbank closed its doors, there was an instant run upon banks and savings banks, and had it not been for the vigorous intervention of the Government and the Reichsbank, disaster must surely have overtaken them. Payments both of marks and of foreign exchange were strictly rationed. On the 14th July all German banks and savings banks were given a holiday by decree, and the stock exchange was also closed. The following day a further decree restricted payments by the banks, for the space of three days, to sums

essential for wages, unemployment insurance, municipal relief and taxes. All foreign exchange transactions became subject to the control of the Reichsbank. The consent of the Government was obtained for a reduction of the note cover below the legal minimum of 40 per cent.; the discount rate was raised from 7 to 10 per cent. and the Lombard rate from 8 to 15 per cent. On the 16th July the banks reopened under these conditions, panic having subsided, and the next day the Danatbank resumed business subject to severe restrictions; it had been granted a moratorium on its debts until the 31st July, when its deposits were to be guaranteed by the Government. The stock exchange was not reopened.

Still further governmental measures had to be taken to prevent financial breakdown in Germany. Decrees of the 18th July compelled German holders of foreign exchange to part with them to the Reichsbank and limited withdrawals from the banks to 5 per cent. of deposits, with a maximum of Rm.20 from savings accounts and Rm.100 from current accounts. On the 21st the legal maximum coin circulation was raised to Rm.30 *per caput* of the population, against an actual figure of about Rm.17. A decree of the 27th July enforced the registration of all debts to foreigners over Rm.500,000. On the 31st July the Reichsbank discount rate was raised from 10 to 15 per cent. and the Lombard rate from 15 to 20 per cent. These measures were accompanied by decrees dealing with non-banking matters. The German banks were also taking steps for their own defence. Forty-five of them combined to form a central clearing-house (*Überweisungsverband*) designed to obviate too rapid a drain upon any one of them. On the 25th July the Reich Government and eleven of the leading banks co-operated in forming an Acceptance and Guarantee Bank to provide funds for banks which had not a sufficient supply of eligible bills to meet abnormal payments, and to take over the State guarantee of the Danatbank's deposits. These endeavours were not altogether successful in preventing a further deterioration of the banking situation. On the 18th July the Rhenische Landesbank, a large institution having total assets of about Rm.1,000 millions, failed on account of the withdrawal of foreign credits from savings banks associated with it,

and on the 20th the J. F. Schroeder-Bank of Bremen put up its shutters; the latter concern was comparatively small (its losses totalled Rm.43 millions, on a share capital of Rm.30 millions), but it was important because the State of Bremen was indirectly implicated in its misfortunes and played an expensive part in its reconstruction. In spite of these troubles, restrictions on banking business in Germany were gradually relaxed, and on the 5th August they were almost completely removed, even from the unfortunate Danatbank, but excepting the savings banks, which were still limited to paying out small sums. The control of foreign exchange dealings by the Reichsbank continued, however, and was being used to ration imports as between the categories of more and less necessary commodities.

(*b*) *The Fall of the Pound*

The Fate that rules over the monetary world had had its sport with Germany. Now it turned its distressing attentions to Great Britain. It was natural that the German difficulties should have exercised a big effect elsewhere. Hungary, whose affairs had been uneasy for some time, succumbed at once, and both bourse and banks had to be closed, the latter reopening after a few days under restrictions similar to those imposed in Germany. In Austria the Mercurbank of Vienna, the great majority of whose shares were held by the Danatbank, and one or two other concerns closed their doors. The Austrian bank rate was raised from 7½ per cent. to 10 per cent. on the 22nd July. But the centre of the trouble was now London. From the 15th July to the end of the month, the Bank of England's gold losses averaged nearly £2½ millions a day, though the daily amounts fluctuated considerably. The first main cause of pressure upon London was what had unfortunately become a normal seasonal attraction of funds to Paris. In the four months June to September 1929, the Bank of England had lost £33 millions of gold; in 1930 the drain came earlier and was not so severe, but from May to July £11 millions of gold was lost. In the summer the operations of the French Treasury and the *Caisse d'Amortissement* invariably deprived the Paris market of funds, which were made up by repatriation of

foreign balances. Undoubtedly in 1931 this movement was accelerated and enlarged by the events in Germany, Austria, and Hungary. French houses had not been very large lenders to those countries, but they were affected by the general apprehension regarding foreign investments. The cessation of war debt payments to Great Britain, transmitted from Germany via France, would also have tended sooner or later to restrict the volume of available funds in Paris, and to draw back money from London. On top of this there was a growing suspicion of Great Britain as a safe repository. The report of the Macmillan Committee on Finance and Industry, published on the 14th July, gave a pessimistic picture of the financial strength of London in respect of foreign obligations at short term, and though the reports of the Economy Committee and of the Royal Commission on Unemployment Insurance, which emphasized the unsoundness of certain aspects of governmental finance, had not yet been published, the general tenor of their comments was already known. However, it appears unlikely that up to the end of July these warnings were of critical importance in determining the course of monetary events, though they undoubtedly became so later.

Whatever the explanation, the gold drain continued for more than a fortnight, in spite of the increase of the bank rate from 2½ to 3½ per cent. on the 23rd July and to 4½ per cent. a week later. Help had to be sought from less vulnerable centres. On the 1st August the Bank of England announced that the Bank of France and the Federal Reserve Bank of New York had placed at the disposal of the Bank of England credits in their respective currencies for the equivalent of £25 millions each, making £50 millions in all. At the same time the fiduciary note issue was temporarily (though later indefinitely) raised by £15 millions to £275 millions.

This announcement immediately allayed uneasiness; the exchange improved and in the week ended the 5th August the Bank actually gained £1½ millions of gold. For a moment there was a lull in the storm.

Germany's position was now somewhat more settled. A

committee of experts had successfully agreed upon the detailed terms of the Hoover Moratorium; a Seven Power Conference, held in London from the 21st to the 23rd July to consider the possibility of satisfying Germany's credit needs, decided on no immediate line of action, but as a result of its recommendations the $100 millions credit of the Reichsbank was renewed, representatives of foreign banking creditors met to consider the prolongation of Germany's short-term obligations, and an expert committee was summoned at Basle, under the auspices of the Bank for International Settlements, to take up the consideration of Germany's credit needs at the point at which the Seven Power Conference had left off. The Basle (Layton-Wiggin) Report was published on the 18th August and was immediately followed by the initialing of a 'Standstill' Agreement by the bankers' representatives. The general conclusions of the Basle Committee, after they had carefully analysed the German economic situation, were, first,

'that in order to ensure the financial stability of Germany, any additional credits provided should be in the form of a long-term loan and that such parts of the existing short-term debt as may suitably be treated in this way should be converted into long-term obligations;'

and, secondly, that there was no possibility of restoring the confidence of investors in Germany's economic stability until political distrust had been removed and, in particular, until the reparations question had been settled. In other words, the economists handed the problem back to the politicians. As their conclusions were received with disappointment in Berlin and with barely concealed resentment in Paris, it is reasonable to assume that they were fundamentally right.

The Standstill Agreement provided for a six months' prolongation (i.e. until the 29th February 1932) of all banking credits in Germany expressed in terms of foreign currencies, on condition that the Reichsbank rediscount credit from the central banks was renewed. In compensation for this ban on withdrawals, the creditors received additional security through the association of the ultimate debtor with the obligation of the intermediary German bank, and through the agree-

ment of the Golddiskontbank to guarantee certain of the credits. These terms did not apply to all Germany's short-term debt. Seasonal crop-moving credits, for instance, and credits extended by non-banking investors, such as commercial or industrial firms, were excluded. Banking obligations expressed in terms of reichsmarks were subject to special conditions; 25 per cent. thereof were to be open to transfer at once, the remainder becoming transferable at the rate of 15 per cent. per month. The escape of certain categories of foreign credits in Germany from the standstill arrangement was responsible for much of the pressure upon the German exchange in the subsequent six months.

Political apprehensions had meanwhile been much relieved by the defeat, in the Prussian referendum, of the Nationalists and Communists, who had combined in an attempt to dissolve the Landtag. The Reichsbank reduced its discount rate, and managed to accumulate foreign exchange. The opportunity was also taken, during the lull in early August, to reorganize the Schroeder-Bank of Bremen and to bring forward a scheme for the reconstruction of the Danatbank. The Reich Government further announced that they had taken over Rm.300 millions of the preferred shares of the Dresdner Bank in exchange for Treasury certificates, the directorate being reorganized at the same time. In Austria the Mercurbank was enabled to carry on with the aid of an advance from a banking syndicate guaranteed by the Danatbank.

But outside Germany and Austria, which pass at this stage out of the centre of the picture, conditions were still deteriorating. Rumania underwent a credit crisis precisely similar in its main features to those of Germany and Austria. In July the Banque Générale du Pays Roumain failed, followed in mid-August by the Banque L. Bercovitz, a large concern with capital and reserves approaching 200 million lei (£250,000). Heavy runs on the banks were only stayed by the intervention of the Government; from the beginning of July to the middle of August the five principal Bucarest banks lost over 3,000 million lei of deposits (£3¾ millions). Public hoarding and the withdrawal of foreign credits were jointly responsible, 500 million lei of foreign money being withdrawn and the note

circulation increasing by 2,500 millions. The defensive measures included the creation of a banking consortium for the purpose of providing bills to be rediscounted at the National Bank, and the transfer of a large block of Steaua Romana (petrol) shares to the Government in exchange for a State obligation.

Hungary was also in difficulties. In 1924 her finances had been restored to health under the League of Nations Reconstruction Scheme, and for five years she maintained her Budget in equilibrium. In 1930–1, however, largely because her agricultural industry was very badly hit by the world depression, a deficit of about £6 millions was incurred. This not only embarrassed her internal banking system, which was not too well adapted to her circumstances, but also injured the confidence of foreign investors. The National Bank had to meet, in the first half of 1931, an exchange deficit of over £8 millions, which it did by depleting its reserves of gold and devisen and by using a rediscount credit of £5 millions advanced by the Bank for International Settlements. Public confidence was further injured by the difficulties of the General Creditbank and by the delay in placing a loan of £4 millions to £6 millions which the Government urgently needed to meet current expenditure. In the end £3½ millions (out of a total of £5 millions) of one-year Treasury bonds were placed abroad in August; the greater part, £2,850,000, was taken up by a French banking syndicate, no British or American subscriptions being forthcoming. Meanwhile, however, a crisis had been precipitated by the Danat failure and the restrictions upon the German banks. On the 14th July the Government declared a three days' bank holiday, and the stock exchange was also closed for an indefinite period. Two days later a decree was issued restricting dealings in foreign exchange and establishing a partial moratorium on foreign obligations. The reopening of the banks caused no difficulty, as the Government had decreed that all banking deposits, claims and debts in pengö should be guaranteed to their full gold value. Count Bethlen having resigned office, the new Government under Count Karolyi undertook a series of financial reforms with the aim of balancing the Budget, but

meanwhile Hungary had virtually isolated her economy from the rest of the world.

It was natural that these European troubles should have reacted upon London, which had liberally—perhaps too liberally—financed the economic reconstruction of Central and Eastern Europe. Not only did London find its own foreign assets largely immobilized, though nominally withdrawable at short notice; other countries in a like pass resorted to London as the chief European market in which they could liquefy their assets. And there were special reasons why they concentrated attention upon London. Doubts were growing as to the soundness of the British financial position. A Socialist Government were in office, though they had done little to implement their creed. The necessity of appealing for assistance to foreign central banks at the end of July had betrayed the weakness of the international financial balance, and the reports of the Economy Committee, the Unemployment Commission, and the Macmillan Committee on Finance and Industry had cumulatively affected the public estimation of London, both at home and abroad. *Le Temps*, commenting on the raising of the foreign credits for the Bank of England, which coincided with the Economy Report, said that they could

> 'in no way dispense the British Government and Parliament from putting an end to the disorder in their public finances, which will give rise, if it be allowed to continue, to a different kind of monetary peril, as serious as that resulting from the German crisis.'

The Treasury was negotiating for a further international loan in defence of the pound, but it was clear that such a thing was out of the question until some at least of the principal recommendations for public economy had been adopted. Money left the country day by day, confidence being far from encouraged by the fact that the Paris and New York exchanges were obviously being pegged. That could only have been done by use of the Bank's £50 millions discount credits, the Bank's own reserves of devisen being plainly inadequate, and on the 23rd August *The Times* disclosed that the credits were almost exhausted. The Cabinet resigned on the following day and the first 'National' Government was formed.

The drain of funds from London was at once diminished, but the position was still insecure. On the 28th August the Treasury issued the following announcement:

> 'For the purpose of strengthening still further the exchange position of sterling, negotiations have been in progress with financial authorities in New York and Paris. They have been concluded on the following basis:
>
> 'In the case of America, the arrangement is that a financial group undertakes, if called upon, to take up British Government dollar treasury bills to a total not exceeding \$200 millions. In the case of France, agreement in principle has been reached with a view to making available 5,000 million francs, partly in the form of a credit from French banks, and partly by an issue of British franc bills to the French public. The sum to be borrowed in each centre will be for the term of a year.'

In New York the advance took the form of an open credit, the rate of interest to be 4¼ per cent. on the amount drawn plus 1¼ per cent. commission on the whole. In Paris an overdraft to the extent of 2½ million francs was granted by the Bank of France on the same terms, franc bills being deposited as collateral; the remaining 2½ millions was raised by British franc bills issued to the public at 4¼ per cent. discount, the borrower to pay tax and other charges equivalent to at least 1¼ per cent. It is important to note that whereas the earlier £50 millions had been lent to the Bank of England, the national Exchequer was the later borrower.

This measure, combined with the establishment of an all-party coalition, and with Mr. Snowden's revised Budget, presented on the 10th September, which aimed at balancing the national accounts by the end of the fiscal year, were generally believed to have saved London from further danger. But the respite was short. Abroad there was no sign of economic improvement. Unemployment in Germany continued to grow, especially in agriculture, which had been particularly hard hit, not only by the fall of world prices, but also by the credit stringency. When the Berlin stock exchange reopened on the 3rd September, after nearly two months' vacation, security prices were about 25 per cent. lower on the average than before the Danat crisis, and there was a further

collapse on the 14th September. Bank shares were particularly weak, especially those of the Dresdner Bank, which had compromised its equity by selling preference shares to the Government. Another disturbing event was the first default on a post-war long-term loan in Germany—an issue of £1 million raised by the Bank für Textilindustrie in 1925.

These German difficulties were now having a very bad effect on the Amsterdam market. Considering the size of that market, its investments in Germany were very large. Its short-term investments had been practically immobilized by the Standstill Agreement and the restrictions on German banking and exchange, and now its long-term holdings were heavily depreciated. In spite of the soundness of the Dutch banks and the apparent confidence of the public, the market was subjected to heavy liquidations, emanating partly from the Netherlands East Indies, which had been specially badly hit by the commodity slump, and partly from Switzerland, which had been even more badly served than Amsterdam by the German difficulties. Part of the pressure was also ascribed to the manipulations of an international group of bear operators, who paid special attention to Kreuger and Toll interests. Among the leading securities listed at Amsterdam, Unilever fell by 17 per cent. between the 14th August and the 15th September, Dutch Ford by 20 per cent., Amsterdam Bank by 19 per cent., Netherlands Trading Society by 28 per cent., and Kreuger and Toll by nearly 40 per cent. The Amsterdam houses, rushing to cover the paper losses thus established, drew heavily on their sterling balances.

The weakness of continental bourses appeared most plainly on the 15th September, and on the same day the British Admiralty announced that the promulgation of pay cuts had caused certain 'unrest' in the navy. This incident would not, perhaps, have excited much attention among financiers in normal times, but in the existing state of public distrust it caused a minor financial panic. Throughout that week the sterling exchange had to be artificially supported, the Treasury credits being heavily drawn upon for the purpose. On the 16th September, British Government stocks were heavily sold, and the pressure grew worse towards the end of the week.

On the Friday, when there was a bad stock exchange slump both on the Continent and in New York, the day's drain on the Treasury credits was reported to be £18 millions. The Treasury was consulting with American and French authorities with a view to raising further credits, but the replies, though friendly, as Mr. Snowden recounted later, 'afforded no prospect of assistance on the scale that was by that time obviously necessary'. After consultation between the Prime Minister and representatives of the Bank of England, it was therefore decided that the gold standard must be suspended if market developments proved unfavourable on the following day. They were indeed most unfavourable, gilt-edged stocks being liquidated on a large scale under pressure from Amsterdam and New York. The Bank of England reported that the credits were practically exhausted. On Monday, the 21st September, Great Britain went off the gold standard.

The Treasury announcement, issued the previous evening, may be left to speak for itself.

'His Majesty's Government have decided, after consultation with the Bank of England, that it has become necessary to suspend for a time being the operation of Sub-section (2) of Section 1 of the Gold Standard Act of 1925, which required the Bank to sell gold at a fixed price. A Bill for this purpose will be introduced immediately, and it is the intention of His Majesty's Government to ask Parliament to pass it through all its stages on Monday, 21st September. In the meantime the Bank of England have been authorized to proceed accordingly in anticipation of the action of Parliament.

'The reasons which have led to this decision are as follows: Since the middle of July funds amounting to more than £200 millions have been withdrawn from the London market. The withdrawals have been met partly from gold and foreign currency held by the Bank of England, partly from the proceeds of a credit of £50 millions, which shortly matures, secured by the Bank of England from New York and Paris, and partly from the proceeds of the French and American credits, amounting to £80 millions, recently obtained by the Government. During the last few days the withdrawals of foreign balances have accelerated so sharply that His Majesty's Government have felt bound to take the decision mentioned above. . . .

'His Majesty's Government have no reason to believe that the present difficulties are due to any substantial extent to the export of capital by British nationals. Undoubtedly the bulk of the withdrawals have been for foreign account. . . .

'His Majesty's Government have arrived at this decision with the greatest reluctance. But during the last few days the international financial markets have become demoralized, and have been liquidating their sterling assets regardless of their intrinsic worth. In the circumstances there was no alternative but to protect the financial position of this country by the only means at our disposal.'

On the same date bank rate was raised from $4\frac{1}{2}$ per cent. to 6 per cent., and the London stock exchange was closed for two days, though the banks remained open and internal business was conducted without restriction and without signs of panic. The next day the Treasury made the following order under a new permissive Act which had already passed all its stages.

'Until further notice purchases of foreign exchange or transfer of funds with the object of acquiring such exchange directly or indirectly by British subjects or persons resident in the United Kingdom shall be prohibited except for the purpose of financing (1) normal trading requirements; (2) contracts existing before September 21, 1931; (3) reasonable travelling or other personal purposes.'

This prohibition was rescinded on the 2nd March 1932.

The most obvious of the causes popularly claimed for Britain's relinquishment of the gold standard was the 'adverse' balance of trade. But it is well to remember the figures and the proportions involved. For many years, through good and bad times, before and after the War, Great Britain had a large debit balance on her commodity trade; that was merely the reward of her great creditor position and of her income from services of all kinds. In 1928, when business was good and the Bank of England actually gained gold, the inward balance of commodity trade was £352 millions, which (according to the estimates of the Board of Trade) was converted by interest earned abroad and by other 'invisible' items into a net credit balance of £117 millions. In 1931 the debit balance of trade

(including silver) had been enlarged to £408 millions, and the final balance had become an estimated debit of £104 millions. This was partly compensated by the decline in the volume of new capital issues for oversea countries, which totalled £143 millions in 1928 and only £46 millions in 1931. Moreover, £130 millions of the trading deficit was incurred in the last quarter of the year, when the gold standard had already been abandoned. The net change from even a prosperous year like 1928 thus represented only a fraction of the actual drain of money in the summer of 1931, which attained a rate of £200 millions in two months. The following table compares Great Britain's position with that of other great commercial countries.

Balances of Commodity Trade. First Nine Months of each Year

(In £ millions)

	Year	*Net imports*	*Exports*	*Balance*
United Kingdom .	1930	717	441	−276
	1931	573	292	−281
U.S.A.	1930	509	597	+88
	1931	332	371	+39
France . . .	1930	316	263	−53
	1931	269	189	−80
Italy . . .	1930	141	98	−43
	1931	99	80	−19
Germany . .	1930	398	421	+23
	1931	256	338	+82

These figures show plainly that, whereas the net balance of Great Britain was almost unchanged between 1930 and 1931, France and the United States both suffered a much greater loss of export trade than of import trade, while Italy and Germany, who improved their position, did so only by dint of enormously reducing their imports.

Financial movements, then, were much more important *immediately* than changes in commodity trade. As the supposed cause of the financial strain, the conduct of the public finances received the broadest publicity. Here again, other

countries were in as bad or worse condition. The May Committee on Public Economy reckoned that on the basis of actual expenditure the real deficit in 1932–3 would be £119 millions. This figure, however, included a 'normal provision', i.e. over £50 millions a year, for the redemption of debt. In France, on a Budget about two-fifths the size of the British Budget, a deficit of some £20 millions was established in 1930–1, and it was reckoned that, but for special economies and additional taxation, she would have incurred a further deficit of some £40 millions in 1931–2. The actual deficit in the United States in 1930–1 was £186 millions (£106 millions allowing for sinking fund), and the estimated deficit for 1931–2, again before counter-measures had been taken, was placed at £436 millions. But perhaps the best comment on the role of the British budgetary deficit in the development of the currency crisis is the fact that the suspension of the gold standard took place, under the coercion of a larger drain of funds than ever, a fortnight after the Budget had been prospectively balanced at the second attempt.

When that is said, however, it must be agreed that both the decline of foreign trade and the unbalanced Budget (especially the huge deficit on the Unemployment Insurance Fund)—painted, as it was, by the May Report in the blackest colours at a moment when public sentiment was at its most nervous—played a part in initiating the drain of foreign funds from London, which was the direct cause of the defeat of the gold standard. Foreign investors, compelled to withdraw some at least of their funds from abroad, and plagued by a general uneasiness concerning world financial conditions, became doubly uneasy about their sterling balances. Once the impression spread that Great Britain might be forced to abandon the gold standard, no normal expedient, whether political or financial, could have prevented them from seeking to rescue their money from London before it was too late.

We must ask, however, how it came about that the apprehensions of foreigners could so readily threaten the basis of the British financial system. Had Britain lent too much to Germany? Britain's long-term investments in that country totalled, in July 1931, some £54 millions, including £24 mil-

lions representing the two great Reparation loans (Dawes and Young Loans). Great Britain had also invested about £100 millions of short-term money in Germany, £18 millions of which had been deposited by commercial and industrial firms mainly for the purpose of carrying on business through subsidiary companies or otherwise. British banks had lent £54 millions to German banks, and only £25 millions direct to industry and commerce and £3 millions to public authorities. Moreover, most of these banking credits were self-liquidating. As the world's financier, London could hardly be charged, on the strength of these figures, with excessive investment in Germany; nor was she much more to blame regarding her financing of other beleaguered countries of Europe, where she had in all perhaps another £50 millions of short-term funds. The financial crisis locked up all this money, nominally realizable at short notice, and prevented London from drawing upon it in defence of the pound.

The charge that Great Britain was 'borrowing short to lend long' can be neither fully substantiated nor completely refuted, for want of adequate statistical evidence. It was estimated that from 1924 to 1930 inclusive she had available for net lending abroad a sum of roughly £450 millions. Capital redemptions on her existing overseas assets probably gave her another £250 millions, and she obtained perhaps £100 millions from the long-term investments of foreigners in Great Britain. That would give her a total of £800 millions available for long-term investment abroad. In the same period new issues on the London market for overseas totalled £820 millions, of which, say, 90 per cent., or roughly £750 millions, was actually exported. This would leave £50 millions for 'direct investments' and for the interchange of existing securities. Thus, unless the statistics of the balance of payments are unsound, there appears to be little truth in the suggestion that on balance during that period London borrowed short money from abroad and put it into long-term investments.

There is unfortunately little statistical evidence of the variation of foreign balances in Great Britain, but a view of some aspects is afforded by the following figures from the report of the Macmillan Committee.

(In £ millions)

	End of year			
	1927	*1928*	*1929*	*1930*
Deposits held on foreign account	206	244	197	247
Sterling bills held on foreign account	175	212	220	153
Foreign advances to discount market	*38*	*47*	*34*	*35*
Total liabilities to foreigners	419	503	451	435
Acceptances on foreign account	*140*	*201*	*176*	*161*
Difference	279	302	275	274

The first broad conclusion to be drawn from this table is that the gross short-term liabilities of London to other countries (including the overseas Empire) amounted to at least £435 millions at the beginning of the crisis year 1931. The second is that £70 millions of the gross liabilities had already been paid off in the previous two years, after the total had reached a maximum in 1928, the year of the restoration of the gold standard in France: between the middle of 1927 and the end of 1928 nearly £130 millions had poured into London. Thirdly, on deducting sterling acceptances on foreign account, but disregarding the deposits of British banks abroad, the dollar bills or other devisen held by them, and all other foreign short-term assets, the net liabilities of London appear to have varied much less than the gross liabilities, though even they had been reduced by £30 millions in two years. No complete evidence is available as to those other assets, but it may be recalled that in Germany alone the short-term investments of British banks totalled £82 millions, of which £43 millions were acceptance credits. It seems probable, therefore, that if on balance London was a short-term debtor, she was so for only a small amount. The trouble was that many of her short-term assets had become frozen, either because standstill agreements had been concluded or legal restrictions placed by foreign Governments on the transfer of funds, or because the assets could only be realized at the cost of jeopardizing the whole financial system of the countries concerned; whereas London remained an open financial market in which money could be deposited or from which it could be withdrawn without stint.

'Beginning with June, the immobilization of foreign credits in

Central Europe and in Germany resulted in sudden demands for funds on the markets most seriously affected by the crisis. In other countries, less directly affected, a legitimate concern for liquidity led the banks to recall part of the balances, both sight and short-term, which they had been holding in England.'[1]

A final word must be added in order to link up the financial position with the trade balance. Although a large proportion of London's liabilities to foreigners were associated with the fluctuations of European currencies and thus would probably have been incurred whatever the level of interest rates, the aggregate might have been considerably less had not the Bank of England been compelled to maintain its discount rate at a level dictated by the pressure upon its gold reserves; and if the British balance of payments had shown a larger credit the pressure would have been reduced or reversed without necessitating a reduction of foreign long-term lending. In some part, then, the suspension of the gold standard in 1931 may be traced back to the over-valuation of the pound on the return to gold more than six years previously, with its inevitable consequences for the national balance of payments, and to the failure to adjust the commercial and industrial structure of Great Britain to the high value of the pound.

(c) *World Repercussions*

After the abandonment of the gold standard, operators in the foreign exchange market were at first at a loss to know what price to place upon sterling. The balancing of the Budget had greatly reduced the force of adverse speculation, but clearly the pound had hitherto been over-valued and the question was by how much. After four doubtful days the London rate on New York fell to \$3·80, compared with a par value of \$4·867, and between that figure and \$3·90 it remained for almost a month, except for a momentary upward leap at the end of September. The progress of the 'National' Government's forces in the General Election caused some speculative bullishness, and on the day of the declaration of the polls (the 28th October) the rate rose at one time to \$3·97. But the wind very soon veered to another quarter, when it was

[1] Annual report of the Bank of France for 1931.

realized that the new Government would probably impose a general tariff. Foreign exporters to Great Britain naturally set out to make hay while the sun was shining, and by the 3rd November the pound had fallen to \$3·73. The lowest rate recorded was \$3·23 on the 1st December; then there was a rally, and at the end of the year the rate was fairly steady at about \$3·40, that is to say, roughly 30 per cent. below parity. In the early months of 1932 the pound appreciated considerably, thanks to a variety of causes—the immediate effect of tariffs on the balance of trade; the effective balancing of the 1931–2 Budget and the prompt repayment of the credits raised for the defence of the pound by the Bank of England and by the Treasury, both of which events greatly enlarged the faith of foreign investors in the future of sterling; the export of gold from India, and other manifestations of desire to take advantage of the 'bargain price' of sterling investments; and the want of confidence in other countries, especially in the United States dollar.

In spite of the large proportion of imported goods, or goods with an internationally determined price, entering into British consumption, wholesale prices in Great Britain did not rise all the way to meet the depreciation of the pound. At the end of 1930 wholesale prices in Great Britain, according to the *Economist*, were 8·9 per cent. above the level at which they had stood just before the suspension of the gold standard. In the same period wholesale prices in gold standard countries had fallen by only 4·75 per cent.,[1] which in view of the depreciation of 30 per cent. in sterling would have indicated a rise of 36 per cent. in prices in Great Britain. It is significant that world gold prices fell sharply both with the original and with the later falls in the exchange value of sterling.

The reactions abroad to the British suspension of the gold standard, the most startling event yet of the financial crisis, were swift and various. All European bourses were immediately closed, for varying periods of time, except Paris, Milan, Prague, and—for domestic stock dealings only—Switzerland. The Paris market had to meet large selling orders, and the

[1] Averages of indices for U.S.A. (Irving Fisher), France (Statistique Générale), Italy (Milan Chamber of Commerce), and Germany (Statistisches Reichsamt).

quotation of Dawes Loan, British consols, and a number of other securities had to be suspended. The Bank of France held sterling assets to the amount of £62 millions, the depreciation on which was covered, after negotiations between the Bank and the Government and a critical vote in the Chamber, by a Treasury bond for the amount of the loss established, exchangeable into bonds of the *Caisse d'Amortissement*, the Bank undertaking to contribute out of its profits to the amortization of the bonds. All over the world, stock exchanges, and especially Wall Street, suffered depreciation of their lists through forced liquidation. When the Tokyo exchange reopened on the 23rd September, there was such a collapse of prices that it had to close again at once, but its troubles had been complicated by the Manchurian embroilment. Credit restriction was the order of the day everywhere, and one after another central banks put up their rates. The following table summarizes the movement.

Central Bank Discount Rates[1]

Country	*Date of change*	*From*	*To*
		Per cent.	Per cent.
England	Sept. 21	4½	6
Sweden	Sept. 21	4	5
India	Sept. 22	7	8
Czechoslovakia	Sept. 23	5	6½
Sweden	Sept. 24	5	6
Denmark	Sept. 25	4½	6
Norway	Sept. 25	5	6
Norway	Sept. 27	6	8
Italy	Sept. 27	5½	7
Greece	Sept. 27	9	12
Netherlands	Sept. 28	2	3
Sweden	Sept. 28	6	8
Bulgaria	Sept. 29	8½	9½
Japan	Oct. 5	5·11	5·84
Sweden	Oct. 7	8	7
Norway	Oct. 7	8	7
New York	Oct. 8	1½	2½
New York	Oct. 15	2½	3½
Sweden	Oct. 19	7	6
Norway	Oct. 19	7	6

[1] The rates, as between countries, do not refer always to the same classes of transactions, and therefore are not properly comparable with one another.

Perhaps the most striking feature of the list is the series of big increases of bank rate in the Scandinavian countries, Denmark, Norway, and Sweden, and the subsequent reductions in the last two. These countries were specially disturbed by the suspension of the gold standard in Great Britain, not only because she accounted for a large proportion of their external trade, but also because they had strong financial affiliations with London. Denmark suspended gold exports on the 22nd September, and although the National Bank declared that it was determined to adhere to the gold standard such urgent pressure was exerted by the organizations of agriculturists, who foresaw themselves heavily handicapped in the British market, that the Government and the Bank were prevailed upon formally to suspend the standard on the 28th September. Norway and Sweden had both gone off gold on the previous day. The case of Sweden is particularly interesting, as thus far she had shown unusual resistance to the depression. Production stayed at a relatively high level, unemployment was moderate and a Budget surplus was established. But her external trade position was becoming very unsatisfactory, and a large import surplus caused her banks to pile up a dangerous weight of short-term obligations to foreign centres. In consequence, the exchange reserves of the Riksbank were subjected to a steady drain, which was swelled to the rate of 95,000,000 krone (over £5,000,000) a week after the suspension of the gold standard in Great Britain. On the failure of negotiations with the purpose of raising a loan in Paris and New York, the Riksbank was forced to abandon its declared intention of retaining the gold standard. Finland was another country to be subjected to a severe loss of foreign exchange, some 500 million finmarks (£2,600,000) being released in the space of three weeks, largely because of the withdrawal of American credits. On the 12th October Finland also abandoned the gold standard. The Scandinavian exchanges did not follow the descent of the pound pace for pace, but were left behind at first. When, in the middle of November, the Swedish crown fell to its gold-parity level of 18·15 to the pound, the Riksbank announced its intention to stabilize at that figure, offering to buy or sell

sterling at fixed rates on production of proper invoices. This measure, which would have resulted, in practice, in exchange control coupled with import restriction, was immediately followed by the appearance of unofficial ('black') markets in currency, by complete confusion in Swedish financial markets, and by the abandonment of the Riksbank's plan. Subject, as it had been, to severe curtailment of its reserves, the Riksbank was indeed without the resources necessary to maintain the crown at a fixed level in relation either to sterling or to gold. In the last quarter of the year the movement of capital and the tendency of foreign trade were both reversed, and the position of the Riksbank improved. Norway and Denmark had similar experiences when they sought to stabilize their currencies on sterling at about the same date. In view of the continued depreciation of the crown, Denmark enforced a concentration of all exchange transactions in the hands of certain banks and stockbrokers, preference being given to the import of industrial raw materials; import taxes on luxuries were also imposed.

It was natural, too, that the greater part of the British Empire should have imitated the United Kingdom. There could scarcely have been any question of the retention of the gold standard in Australia or New Zealand. Canada, who had effectively abandoned the international gold standard two years previously, decided, largely on account of her heavy financial commitments to the United States, not to let her exchange fall with sterling, but the Canadian dollar could not be prevented from depreciating heavily on New York. The already existing practical prohibition of gold exports from Canada, except under official authority, was formally embodied in an Order-in-Council on the 19th October. In South Africa, where economic considerations had become entangled with party politics, General Hertzog's Government decided to keep to gold, in spite of opposition from exporting interests. Both Northern and Southern Rhodesia, on the other hand, suspended the gold standard on the 12th October. There was some outcry among Indian nationalist politicians at the instant decision of the Government of India to continue to link the rupee exchange with sterling, but the agitation was

directed against the form rather than the substance of the action, as India could plainly not have afforded both the handicap to her overseas trade and the depreciation of her sterling assets held against currency. A three days' bank holiday was proclaimed, and exchange transactions were subjected to control. Opposition was likewise raised by Republican elements in the Irish Free State, where the currency had all along been based on sterling, not directly on gold, and where British money circulated freely, but there could be little doubt of the propriety of Mr. Cosgrave's decision to retain the attachment to sterling. The Egyptian currency, which had been stabilized in relation to sterling, was also allowed to follow the pound, gold exports being prohibited.

It was suspected in some quarters that Italy might be forced off gold, and the lira showed weakness for a while, but it recovered when the Government gave assurances that there was no intention of departing from the gold standard. Similar rumours were current regarding Germany, but her authorities insisted that she could not afford thus to force up the cost of her enormous external obligations. The withdrawals of money which forced down the reichsmark exchange were ascribed mainly to the realization of mark balances under the Standstill Agreement. It also appeared likely that, in circumvention of the restrictions upon exchange, German traders were paying off sterling debts at a profitable discount out of the proceeds of exports. In the week ended the 2nd October the Reichsbank lost Rm.233 millions of gold and foreign exchange. In Austria a fresh crisis was brought about; the National Bank had to withstand a severe drain of foreign funds, as it was known that big losses had been incurred on sterling assets held against notes under the gold exchange standard. The sale of foreign currencies was subjected to restrictions, and the Vienna Bourse was closed for a while, the authorities fearing the repercussions upon public confidence of sales of Austrian securities by foreigners seeking to cut their losses. It appeared also that Austria was being used as a channel for securing foreign exchange by nationals of neighbouring states. In Hungary the effects of the crisis were likewise restricted by the control of exchange dealings and

the closing of the bourse, both of which measures had already been in effect for over two months. Poland and Czechoslovakia (like Italy) were financially little affected, but they were very apprehensive about the commercial results of the sterling depreciation. Poland managed to maintain her coal exports in the Baltic area by continuing contracts on a sterling basis, but this naturally involved the exporters in a considerable loss, in spite of the governmental assistance given in the form of subsidized freight rates on the railways. At the end of September the National Bank of Czechoslovakia established a system of foreign exchange supervision, and, that having proved ineffective, the Government issued a decree compelling the surrender of all exchange to the National Bank and rationing exchange for effecting payments abroad.

Several countries suffered seriously from the depreciation of their sterling reserves, among them the Netherlands. On the 27th September the Netherlands Bank stated its belief that arrangements could be made to obviate any loss on the reserve deposited in London. Early in December, however, the Bank declared that 'it is evident that the Bank of England is not inclined to acknowledge the claims which the Netherland Bank considers it was reasonably entitled to make'. The greater part of the sterling assets had been sold forward to the Netherlands East Indies Government for the redemption of two loans, aggregating £11 millions, which would fall due in 1933, and the remainder had been realized in the open market. The consequent loss, which occasioned the passing of the current dividend, would be offset by administrative economies. Greece was also in a difficult position, as roughly one-quarter of her central bank reserve was deposited in London, and therefore had to be written down as the pound depreciated. Nevertheless, she retained the gold basis for the time being, but a law of the 28th September, amplified by a further measure a month later, ordered the concentration of all exchange business in the hands of the Bank of Greece, which issued foreign currencies 'for indispensable economic needs' only. A large portion of the Greek public debt, having been contracted in terms of sterling, was being remunerated in depreciated currency. It was not until the end of April

1932 that Greece definitely abandoned the gold standard. Japan was another country to stave off the suspension of the gold standard for some time. The weakness of her balance of payments (especially the grave loss of shipping earnings), the realization that the simultaneous depreciation of the pound sterling and of the rupee would seriously handicap her in some of her most important oversea markets, the direct injury done to her trade by her quarrel with China and the fears that it engendered among investors regarding her political and economic future, all combined to draw out gold from Japan, the loss amounting to 204½ million yen (£20 millions) in the space of eight weeks after the 18th September. On the 13th December, the Seiyukai Party having ousted the Minseito from office partly on this issue, the gold standard was suspended, and by the end of the year the yen had fallen from 2*s.* 9*d.* to its old sterling parity of 2*s.* 0½*d.*

In April 1932 the principal countries of the world could be classified as follows:

Gold Standard: Albania, Belgium, Cuba, Dominican Republic, France, Guatemala, Haiti, Indo-China, Italy, Lithuania, Luxembourg, Mexico (theoretically), Netherlands, Panama, Persia (nominal), Peru, Poland, Rumania, Siam, South Africa, Switzerland, United States, with the dependencies of such of the above as are Colonial Powers.

Gold Standard Ineffective: Austria, Bulgaria, Canada, Colombia, Costa Rica, Czechoslovakia, Estonia, Germany, Honduras, Hungary, Jugoslavia, Latvia, Newfoundland, Nicaragua, Turkey, U.S.S.R., Venezuela.

Gold Standard Suspended: Argentina, Australia, Bolivia, Brazil, Chile, Denmark, Ecuador, Egypt,[1] Finland, Greece, Indian Empire, ʿIraq,[1] Irish Free State,[1] Japanese Empire, New Zealand, Norway, Paraguay, Portugal,[1] Rhodesia (Northern and Southern),[1] Salvador, Spain, Sweden, United Kingdom and dependencies, Uruguay.

Silver Standard: Abyssinia, Afghanistan, Arabia, China and Manchuria (currency actually chaotic), Hong Kong, Tibet (standard not effective).

Among the countries which sought to intercept the commercial consequences of Great Britain's action by imposing

[1] Linked to British currency.

special customs duties were Canada, South Africa, France, Italy. While 'anti-dumping' measures were not immediately introduced in the Netherlands, the abnormal competition of British and Scandinavian products was acutely felt there, and the measure then afoot for the increase of the general tariff from 8 to 10 per cent., though designed for revenue purposes, was welcomed in some quarters as a step towards protection. Later, after the Abnormal Importations duties had been imposed in Great Britain, and prices had been depressed by governmental decree in Germany, the Netherlands applied a general system of non-discriminatory import quotas.

Widespread banking difficulties arose directly or indirectly out of the sterling crisis. The United States suffered another wave of the flood of banking failures which had characterized her economic course ever since October 1929; the depreciation of sterling was not directly responsible, as American banks were understood to hold only a very small volume ($50 millions) of funds in London and to have hedged their commitments, but the credit system found it difficult to withstand the extreme weakness of the bond market. Not only were central banks and private investors being forced to cover their losses on sterling and other currencies which depreciated with it, by drawing on their balances elsewhere, but several countries, without any formal change, gradually forsook the gold exchange standard for the full gold standard, converting their holdings of devisen into metal. The result was a sudden depression of the value of the dollar, and a loss of gold by the United States. In the months of September and October exports of gold *plus* net earmarkings amounted to $805 millions, against imports (from Japan and South America) of $90 millions. So large a movement inevitably gave rise to public uneasiness and even to rumours that the United States might be forced to abandon the gold standard. Although ample reserves of free gold remained, and although the sound banks, especially the big New York institutions, were in an unprecedentedly liquid condition, there were certain ugly features of the internal financial situation which justified some anxiety. The first was the vast hoarding of currency (estimated by some at $1,000 millions) induced by the failure

of so many banks and by the complete absence of banking facilities in some localities. The second was the enormous prospective Budget deficit, officially estimated in December at $2,123 millions for 1931–2, a forecast which later proved to be far below the mark. This fact, combined with a general 'flight from securities', caused a severe slump in the market for Government bonds, and thus threatened the technical solvency of many banks and other fiduciary institutions holding Government paper in their reserves. The National Credit Corporation, formed in October, was designed to meet this situation by providing resources for banks in difficulties, and although its actual loans amounted to only a small fraction of the potential resources with which it had been provided, it did do something to restore public confidence, and the toll of bank failures was thereafter somewhat diminished.

In France the Banque Nationale de Crédit found itself in deep water and was only rescued with the aid of a guarantee fund established by the leading French banks. One or two banks of minor importance ceased payment a little later. In Switzerland apprehensions were aroused by the knowledge that a considerable proportion of Central European bills held by Swiss banks were expressed in sterling denominations; banks, however, were generally in a highly liquid condition, and gold was pouring into the country. The credit system of Germany was being strained to the utmost. Banks of the second rank in Berlin, Cologne, Leipzig, and Dresden put up their shutters. The savings banks were also giving cause for anxiety, over Rm.800 millions having been withdrawn from them in the space of three months. Another series of financial decrees was imposed, further restrictions being placed on foreign exchange dealings. On the 19th September a Banking Board of Control and a Banking Commissioner had been appointed to supervise private banks. The Commissioner, who was given full powers of demanding information, was charged with the duty of 'influencing banking policy in the economic interest of the community'.

The economic condition of Germany, indeed, continued to deteriorate, and further emergency measures had to be taken to secure adjustment. A special Economic Advisory Council

was opened by the President on the 29th October, and proceeded to set up committees to deal with wages, prices, interest rates, the provision of employment, and the negotiation of a new Standstill Agreement. The Council, however, failed to secure any substantial measure of agreement on the critical issues. On the 8th December another emergency decree was signed prescribing, *inter alia*, (1) the reduction of wages and salaries to the level of 1927; (2) the lowering of prices to a level 10 per cent. below that ruling in July 1931, under the authority of a price-regulation commissioner with wide dictatorial powers; (3) a 10 per cent. cut in rents; and (4) the levelling of fixed interest rates of between 6 and 8 per cent. to the rate of 6 per cent., with corresponding reductions in higher rates. The attempt at compulsory price reduction was not entirely effective; a 10 per cent. cut was made in the prices of coal and pig-iron, and the price commissioner was fairly successful in his efforts to bring down the prices of bread and meat, but in seeking to enforce cuts in public utility charges he met with great opposition from the local authorities, whose budgets were already in deficit.

These adjustments did not prevent the growth of unemployment and the gradual atrophy of German industry. Most of the big industrial concerns passed their dividends for 1931 altogether, and a number of important firms failed. Meanwhile, in spite of a declining trade balance at the end of the year, the Reichsbank was successfully, but not without severe strain, conducting its defence of the exchange. The difficulty of its task is illustrated by the fact that between the 1st September and the 7th November receipts of foreign exchange from the proceeds of exports and other minor sources amounted to only Rm.1,297 millions, against demands totalling Rm.1,761 millions, including Rm.784 millions for imports and Rm.690 millions for the repayment of short-term credits. The extent to which credits were being paid in spite of the Standstill Agreement was truly remarkable; at the end of November Dr. Luther stated that since the autumn of 1930 as much as five milliards (£250 millions) of short-term debt had been repaid.

Across the frontier in Austria things showed no signs of

improvement. The negotiations for the resuscitation of the Credit-Anstalt were difficult and protracted. The debts of the bank which it was necessary for the Austrian Government to guarantee proved far in excess of the original estimate of a mere 140 million schillings. It was stated that in the middle of November the National Bank of Austria had discounted bills to a total of 608 million schillings for the Credit-Anstalt, and that the total guarantee of the Federal Government on the latter's behalf had been 1,400 million schillings, of which 1,200 million schillings were then outstanding. This undertaking was naturally proving a great embarrassment to the Government and a threat to the solvency of the national finances. In spite of severe retrenchment and additional taxation, attempts to balance the Budget had so far failed. Difficulties were also encountered in the operation of exchange control. The restriction of exchange releases for imports provoked Austria's neighbours into retaliation. A clearing agreement with Switzerland was arranged in December, but negotiation with other countries was protracted, and meanwhile Austria's foreign trade was being diminished to a fraction of its former level. So far from securing adjustment, the restriction of exchange actually exaggerated the economic isolation of Austria; for under its shelter there was a tendency for internal commodity prices, and even at one time stock prices, to rise, while in the outer world deflation continued.

IV

DEPRESSION, 1931–3

(a) *Tariffs and Exchange Control*

BY the end of 1931, the year of crisis, the thunder of the financial explosion had died away and only the echoes reverberated still. The banking system of Germany had been restored to solvency if not to strength. Artificial supports of one kind or another were propping up the financial systems of Central and Eastern Europe. The pound sterling had reached what appeared at that time to be a natural level, and a fairly well-defined group of currencies had attached themselves to it. The extraordinary 'toughness' of the capitalist system had been tested and proved, buttressed as it was in many countries by further and further encroachment of Government activity into the former field of private enterprise in production, trade, and finance. Firms and individuals, aided by the decline of costs either through legislative action or through more natural processes, and spurred on by the normal incentives of capitalist trade and industry, were still finding means of curtailing their losses or of making profits, while most Governments were facing their fiscal problems with determination and reducing their deficits, even though scarcely any of them could achieve surpluses.

With scarcely an exception, tariffs were rising throughout the world. In Australia, with the advantage of exchange depreciation,[1] a Government was in office pledged to cut down the tremendous protective tariff associated with the name of Mr. Scullin; but even there little effective reduction was achieved before the end of 1932. In the United States, the Democratic Party, officially pledged to reduction of the Hawley-Smoot tariff, already held the balance of power in Congress, but the only significant alteration of the American tariff in 1932 was the addition of high import duties on copper,

[1] See above, p. 92, for a classification of the world's currencies in April 1932. Between that date and the end of 1932, Siam, Peru, and South Africa abandoned the gold standard; and Rumania and Persia introduced foreign exchange restrictions which rendered the gold standard ineffective.

lumber, and oil, in the course of the passage of the Tax Bill—this with the aid of Democratic votes. The most notable addition to the tariffs of the world was, of course, the British Import Duties Act. After a brief experiment with a temporary tariff, concentrated on certain luxuries or non-essential goods and in many cases intended to be practically prohibitive, on the 1st March 1932 Great Britain stepped into the ranks of the moderate tariff countries of the world. A general 10 per cent. tariff (subject to certain exceptions, mostly staple foodstuffs and raw materials) was to be augmented by a series of more or less protective duties on manufactured goods, ranging up to a total duty of $33\frac{1}{3}$ per cent. *ad valorem*, on the initiative of an independent tariff board with wide terms of reference adverting to the 'advisability in the national interest of restricting imports into the United Kingdom'. None of these duties was to apply to imports from other parts of the British Commonwealth, but this provision was of minor importance in relation to manufactured goods. As the months passed, more and more duties were added under successive recommendations of the tariff committee.

It is impossible to compute how far the imposition of the British tariff was responsible for subsequent increases of tariffs elsewhere, but it was certainly an episode in the universal tariff war that was raging throughout this phase of the world crisis. In the first place, the popular demand for a tariff in Great Britain was influenced by the growth of tariffs on British goods entering foreign countries, and by the feeling not only that a free-trade policy was incompatible with such restriction of British exports but also that a tariff was necessary as a bargaining instrument to secure the reduction of foreign duties. In the second place, the sudden reduction of international lending had compelled debtor countries to achieve outward balances of trade, partly by stimulating exports and partly by restricting imports; if, then, further obstacles were to be opposed to their exports by creditor countries, they had no alternative but to enhance their restrictions upon imports. In the third place, in certain instances there is evidence of definite retaliation.

It was, no doubt, accidental though it was unmistakable

that the British tariff pressed particularly hardly on German products. Whereas in 1930 over 89 per cent. of imports from Germany came in free of duty,[1] had the post-Ottawa tariff been in force 24·2 per cent. of such imports would have been subject to 10 per cent. duty, 49·7 per cent. to duties ranging from 11 to 20 per cent. *ad valorem*, and 10·9 per cent. to duties exceeding 20 per cent. *ad valorem*, in addition to the 10·7 per cent. already subject to duty in 1930, leaving only 4·5 per cent. of the imports free of tax. These figures for Germany may be compared with the following for imports from all foreign countries: in 1930, free 83 per cent. and taxed 17 per cent.; after Ottawa, free 25·2 per cent.; subject to 10 per cent. duty, 28·3 per cent.; subject to 11–20 per cent. duty, 21·8 per cent.; subject to over 20 per cent. duty, 7·7 per cent. The achievement of an outward balance of trade by Germany—sufficient to pay her obligations for interest and long-term capital amortisation, though it left nothing over for reparations—was one of the most remarkable features of international economic life in the first three years of the slump. In 1929 Germany's imports totalled over £670 millions, exceeding her exports by £40 millions. Yet in 1930 her exports, at £610 millions, exceeded her imports by £80 millions, and in the following year the outward balance had been increased to £140 millions, in spite of a reduction of exports to only £485 millions.[2] As a result, however, of the growth of tariffs elsewhere and the depreciation of exchanges against the mark, along with the general decline of international trade, this balance showed signs of serious diminution before 1931 was out, and the British tariff further gravely aggravated Germany's difficulties.

Therefore it was not surprising to find the German Government referring to the British duties when they replied to an official protest against the restrictions laid upon imports of British coal into Germany, by means of the quota system. In 1931, imports of British coal and coke into Germany had totalled 3,900,000 tons, including some 850,000 tons delivered

[1] *The Economist*, supplement to issue of the 22nd Oct. 1932.

[2] Except where otherwise stated, all conversions from foreign currencies in this chapter have been calculated at gold parity.

in free port areas for bunkers, this category not being subject to quota regulation; under the quota order of March 1932, imports within the quota scheme were to be reduced to 1,500,000 tons in the year 1932. The system of quota regulation in the coal trade was of old standing in Germany, and it was not against the principle of it that the British Government were protesting, but against alleged violation of most-favoured-nation rights assured to Great Britain under the Anglo-German commercial treaty of 1924; it was claimed that the quotas allotted to other countries had not been proportionately reduced because Germany had special agreements with them relating to reciprocal quotas. Later it became known that there was also in existence a document not taking the form of a treaty but containing a unilateral undertaking on behalf of the German Government not to alter for the worse their regulation of the coal trade during the currency of the Anglo-German trade treaty. The reply of the German Government to the British protests was to the effect that the whole basis of the treaty had been fundamentally altered by the imposition of the British tariff; they requested a discussion of the latter duties in so far as these bore specially hardly on German exports. The British Government, however, while accepting the principle of arbitration on the quota issue, refused to allow their tariff policy to be called in question. This attitude was modified after the Ottawa Conference, and during December 1932 official discussions took place in Berlin concerning on the one hand the British tariff on certain articles of special interest to German trade, and on the other the German quota on British coal. Only a preliminary exchange of views was completed by the end of the year, but later a limited agreement embodying mutual concessions was initialed and duly ratified, not without protest from those British industries whose measure of protection had been thereby curtailed.

The coal quota was not by any means the only addition to existing restrictions on trade imposed by the German Government during 1932, nor the only one to arouse international antagonism. In January a decree was promulgated empowering the Government in cases of urgent necessity to impose a

compensating surcharge on goods coming from countries whose exchanges had fallen below gold parity, and to impose increased customs duties on goods coming from countries with which Germany had no commercial treaty or from which Germany did not receive most-favoured-nation treatment. The primary object of the decree was apparently to stop abnormal imports of butter from Denmark, who had been given a considerable advantage in the German market by the depreciation of the kronor. This action aroused deep resentment in Denmark, but it was not until October that a new tariff was imposed by the Danish Government, involving large increases of duties upon foodstuffs as well as industrial articles, especially silk and rayon and manufactured clothing, and frequently changing *ad valorem* into specific duties—the protective effect of the former (as many another country found) having progressively diminished as the general level of prices fell. While this tariff was felt sharply by German exporters, its declared purpose was simply to right Denmark's failing balance of trade. In February 1933 another round of this bout between the two countries was begun. The Reich Government (in which Herr Hugenberg was Minister for Food and Agriculture and for Economic Affairs) raised the protective duties on live-stock, meat, and lard, in many cases to at least double their former level. The new duties were to come into operation on the 15th February, upon the expiry of the German-Swedish trade treaty. Apart from their effect on other countries, these drastic measures threatened to reduce Danish exports to Germany to a mere fraction of their former value, and in retaliation the Danish authorities responsible for the allotment of foreign exchange proceeded equally drastically to prune Germany's exports to Denmark.

The chief countries affected by Germany's new 'super-tariff' against countries with whom she had no commercial treaty were Canada and Poland, with the latter of whom Germany had for long been engaged in a devastating tariff war. With Canada, negotiations for the conclusion of a treaty were soon begun, and eventually met with success. On the 1st September 1932 the German Government further increased the duties payable on many industrial and agricul-

tural products. These changes appeared to be directed principally against British goods; for duties on many categories of textiles and clothing, being British specialities, were raised considerably, some of them trebled. Other imports to suffer were American machinery and important Czechoslovak products. A month later, in response to persistent agrarian agitation, a score of import quotas was imposed on agricultural products, including butter, lard, bacon, and many market-gardening products. In February 1933 the Reich Government added to the restrictions already mentioned (including the raised duties on live-stock, meat, and lard) a series of measures designed to eliminate all German imports of cereals except such as were balanced by an equivalent export of cereals. By this time industrial and financial interests were seriously alarmed by the bad will, and in some cases explicit retaliation, engendered abroad by these restrictions, and by the internal conflict of interest between town and country.

The quota system was used by France, too, as a means of protection for her industry and agriculture, and of arresting the steady change of her external balance of commodity trade from a surplus to a deficit, which had been going on ever since 1928. During 1932 the system was widely extended. In the course of an unofficial exchange of protests initiated by the British Chambers of Commerce, the British tariff and propaganda in Great Britain against the purchase of foreign goods were mentioned as contributory reasons for the reduction of France's imports by quotas. In a public statement explaining the system Monsieur Rollin, Minister of Commerce in the Tardieu Government, said that to have increased tariffs alone would have been useless, for in the period of a crisis no tariff wall, unless fantastically high, could prevent the movement of enormous accumulated stocks. Moreover, nearly three-quarters of France's tariff duties had been consolidated under commercial agreements between 1927 and 1928, and the Government could not alter them. It was soon found, however, that the effect of restrictive quotas was a great rise in the cost of living, indeed occasionally acute shortage of certain goods, including some foodstuffs, besides the retaliatory

measures of other countries; and from the 1st July the system was relaxed, in preparation, it was officially said, 'for a progressive return to a greater liberty of international exchange'. The majority of the quotas were enlarged, the increase of the coal quota being of special advantage to Great Britain. On the other hand, French importers of coal were compelled, as from the 1st September, to ship 50 per cent. of their coal in French bottoms.

Early in June 1932 the Economic Committee of the League of Nations reported that since the beginning of 1930 practically every country had remoulded its customs tariff on a more or less extensive scale, or had increased its import duties on particular products; and that in the past few months alone, for example, Belgium, Denmark, Estonia, Italy, Latvia, Lithuania, the Netherlands, Poland, Portugal, Rumania, Sweden, Bolivia, Brazil, Siam, the Union of South Africa, and —'most striking development of all'—the United Kingdom had increased their duties in some cases on important categories of goods, or even the whole of their tariffs. Moreover, measures for the direct regulation of trade had been widely adopted, of which the most frequent were measures to establish import quotas or to institute import licences or permits. Austria, Belgium, Czechoslovakia, Denmark, Estonia, France, Germany, Greece, Hungary, Italy, Latvia, Norway, Poland, Rumania, Spain, Switzerland, and Turkey were the chief countries in Europe which had introduced such measures. While these regulations were applicable—in Belgium, Denmark, Germany, and Rumania, for example—only to certain groups of goods, or (as in Italy) were strictly limited to goods specified as coming from particular countries, they had been continuously intensified in France, Estonia, and other countries, and actually extended in Latvia and Turkey to the whole volume of imports. Certain countries, such as Estonia and Persia, had preferred the system of import monopolies to the system of import quotas or permits, while others, such as Spain, Portugal, and Colombia, had rigidly prohibited the importation of particular products. A number of countries, furthermore, had not restricted these regulative measures to the import trade, but had adopted a system of permits for the

export of particular products (as in Denmark and Spain) or for all exports (as in New Zealand).

It is quite impossible to review comprehensively the various aggravations of trade restriction, occurring all over the world, in creditor and debtor countries, in retaliation one towards another and in a general attempt to secure that elusive and illusory trophy, an outward balance of trade. All that can be done here is to mention a few instances of illustrative importance. The Chinese Government imposed heavy duties on the import of luxury articles, medicines, and toys, that is to say, goods bought chiefly by foreigners, but the principal reason was apparently the need for greater revenue, and this was a motive which operated in other countries, including Great Britain herself. In India, the influx of Japanese cotton goods through the depreciation of the yen forced the Government to refer the question of further protection for local industry to the Tariff Board, on whose recommendation import duties on cotton piece goods not of British manufacture were raised on the 30th August 1932, generally from 20 per cent. to 50 per cent., less the existing 11¾ per cent. surcharge, the net increase being thus 18¼ per cent. *ad valorem*; but as the Board's calculations were based on an exchange rate of Rs.106 to 100 yen, and the actual rate was Rs.86 to 100 yen, the Japanese manufacturer continued to enjoy a substantial advantage.[1] Here again was a motive which operated very generally, both in Europe and in the Old World. In view of the attitude of the German Government towards British complaints about their own quota on coal imports, it is interesting that they were reported, in August 1932, to be appealing to the most-favoured-nation clause in a dispute with Belgium over the latter's progressive reduction of quotas on imports of coal. Finally, there must be mentioned the new Uruguayan tariff promulgated in the same month; for it embodied a principle frequently championed in public controversy over tariffs, in

[1] On the 6th June 1933 the Government of India announced that, the yen having remained for six months at approximately Rs. 82 to 100 yen, the import duties on cotton piece goods not of British manufacture would be raised to 75 per cent. *ad valorem* (or, in the case of plain grey piece goods, 6¾ annas per lb., whichever was the higher). Discrimination against Japan was precluded by a trade convention between the two countries.

spite of the obvious economic fallacies inherent in it. Duties were to be reduced on goods imported from countries with which Uruguay had a favourable balance of commodity trade exceeding 1 million pesos per annum, while an additional tariff was to be imposed on goods from other countries in proportion to the adverse balance of Uruguay's trade with them. It may be noted that this measure promised to award valuable preference to Great Britain, but that its full implementation was prevented by the existence of most-favoured-nation treaties.

Restriction of trade and financial intercourse through control of exchange operations was almost as universal as the heightening of tariffs. In a few cases, however, there was actually a relaxation of such control. In Great Britain there never had been any general supervision of transactions involving the sale of foreign exchange, but a ban was placed upon new capital issues for other countries—indeed upon all new issues during the process of National Debt conversion. This was slightly relaxed on the 1st October 1932, when a Treasury notice stated that no further restrictions in the way of new issues were required, except (until further notice) (*a*) issues on behalf of borrowers domiciled outside the Empire or issues the proceeds of which would be remitted abroad, and (*b*) the optional replacement of existing issues by new issues involving either underwriting or an invitation to the public to subscribe new cash. In Sweden and Finland exchange control was removed in December 1931. In Portugal and Spain the difficulties in the way of exchange transactions were reduced in the course of the year, while in Venezuela the rationing system adopted by the banks was removed. In reply to a parliamentary question on the 13th June 1932, the Secretary to the Overseas Trade Department of the Board of Trade said that the countries in which restrictions upon exchange transactions were operative were as follows: Austria, Bulgaria, Czechoslovakia, Denmark, Estonia, Germany, Greece, Hungary, Iceland, Latvia, Portugal, Rumania, Spain, Turkey, Jugoslavia, Portuguese East Africa, Portuguese West Africa, Portuguese Guinea, Argentine, Bolivia, Brazil, Chile, Colombia, Costa Rica, Ecuador, Nicaragua, Salvador, Uruguay.

In three countries—Italy, Lithuania, and Norway—registration or supervision was undertaken by the banks.

Germany was the foremost exponent of exchange control, and in the course of 1932 the restrictions she imposed were tightened progressively in view of the failing export balance achieved. In 1931 the average monthly excess over imports was more than Rm.200 millions, whereas in only two months of 1932, March and September, did the monthly surplus exceed even Rm.100 millions. The various means of evasion (for instance the tender of German securities by foreign firms as payment for goods supplied, in lieu of foreign exchange) were stopped one after another. By April the quotas of exchange allotted to importing firms had been limited to 25 per cent. of their foreign exchange requirements in October 1930. The total imports, however, were not restricted in quite the same proportion, largely because importers made use of foreign credit lines becoming available through the agreed liquidation of credits under the standstill arrangement. Another point of interest in connexion with German exchange control was the prohibitive export duty (Rm.8 per Kg.) placed on the export of used machines and parts, in order to prevent the setting up of businesses abroad by German firms seeking to escape the high costs of production at home and protective tariffs abroad. Thus move and countermove followed in rapid succession in the suicidal game of trade-snatching. An incident of the game was the cancellation by Germany of the concessionary arrangement with Italy whereby the latter paid for imports from Germany out of blocked accounts in marks. Italy responded by paying net mark debts as to three-quarters in blocked lire; and after three and a half months of tension Germany capitulated, the former arrangement being renewed.

In some countries management of exchange transactions was reinforced or replaced by direct control of imports. This was so in Austria, for instance, where a system of import control over a wide list of commodities, including foodstuffs, textiles, motor-cars, and a great many other manufactures, was imposed on the 1st May 1932. Another country to use the method of direct import control was Denmark. Upon the

abandonment of the gold standard by Great Britain, 'as a means of facilitating trade and controlling currency, a foreign exchange committee was established under the aegis of the National Bank, who could, on the one side, direct Danish imports to the countries who were the principal receivers of Danish exports, and, on the other side, curtail the import of luxury goods which Denmark at a time of crisis could ill afford. This arrangement proved to be very much in favour of England.'[1] On the 10th October 1932 it was announced that the currency restrictions then in force were to be abolished, and in place of the foreign exchange committee there would be instituted a special board for all foreign trade; at the same time a series of tariff increases was submitted.

In Rumania a Bill was passed in February 1932 to regulate dealings with countries where currency restrictions were in force; all payments for imports from such countries were to be made through a special compensation department of the National Bank. In May this system was made more rigorous, the export of currency being prohibited and all exchange operations being centralized at the National Bank. When Hungary's trade treaty with Austria expired and the latter proceeded to clap on a tariff which severely injured Hungary's seasonal export of fruit and vegetables, specific action was taken to restrict the sale of Austrian schillings.

'The effect of all these forms of restriction on commercial relations can easily be imagined. Every import is necessarily an export in another country; thus, there developed a process by which these foreign exchange restrictions produced, by their cumulative effect, a disastrous influence on the trade of those countries, both with each other and with third countries, at a time when international trade was so badly hit by the world crisis.

'Naturally, means were sought for attenuating these consequences, more particularly by agreements involving essentially exchanges of goods. The international clearing conventions belong to this group. Without going into details, it may be noted that these clearing conventions did not yield appreciable results, except when the monetary situation of the two contracting countries was practically equivalent.

'Each state has tried to protect itself by shifting to others the

[1] Statement of the Danish Legation in London, 8th June 1932.

consequences of a general situation; each has tried to push its exports and to reduce its imports to a minimum, this being indeed essential if it was to be able to ensure the service of the external debt. This policy might have produced results if it had been pursued by one country alone and if the others had accepted the situation. But, as each country was taking identical measures on a national basis, these measures neutralized one another. The result was—experience on this matter is conclusive—not only nil, but negative; it seriously increased the difficulties which it was desired to remove. In no case was the individual problem solved.'[1]

Representatives of the national committees of the International Chamber of Commerce, meeting in Paris on the 7th March 1932 to inquire into the operation of foreign exchange restrictions, denounced them not only as restricting trade but also as leading to an alarming and dangerous degree of state interference with private trading. The report particularly condemned bilateral clearing arrangements as an inadmissible form of indirect preference.

The breakdown of the ordinary processes of international trade, and the inability of the credit system at this period of crisis to solve the paradox of excess in producing countries over against want in consuming countries, forced the world to turn in despair to primitive barter. Several instances of international barter through governmental agency occurred during 1932. Naturally, the Soviet Government were in the best position to act in this way, and several barter agreements were negotiated for the exchange of Russian oil and other products for goods of which the Soviet Union had need. One of the most notable instances was the undertaking of the Aluminum Company of Canada to dispose of a quantity of Russian oil taken in exchange for large shipments of aluminium. A ban on certain Russian imports was in force in Canada, and for some time it was doubtful whether the Canadian Government would allow the clearance of the oil cargoes, especially in view of the strong stand that they had taken over trade with the Soviet Union in their negotiations with the United Kingdom Government at the Ottawa Conference;

[1] Report of the Stresa Conference for the Economic Restoration of Central and Eastern Europe.

but the threat of losing an order involving the employment of several hundreds of men was apparently sufficient to outweigh scruple. Towards the end of the year negotiations were afoot for a similar exchange of Russian coal and oil for Canadian cattle and hides. Two German examples of barter may be cited as typical. A group of Bremen cotton firms entered into an agreement with the Banque Misr of Cairo and the Agricultural Credit Bank of Egypt for the exchange of 20,000 bales of Egyptian cotton against an export of German nitrate; there was no transfer of foreign currency, the Bremen cotton merchants merely crediting a sum in marks to the nitrate manufacturers. A coal-mining company of Duisberg-Ruhrort contracted with the Brazilian Government for the delivery to the Brazilian state railways of 350,000 tons of coal in the course of some six months, to be taken in direct exchange against additional German imports of Brazilian coffee. But a few isolated instances of barter, on however large a scale, could scarcely affect the whole body of international trade, with its complications and specialization, in a significant measure.

More important than these individual contracts were the numerous inter-governmental agreements, among European countries employing or suffering from measures of import control, for the exchange of particular commodities in specified amounts. Germany and other countries of Central and Eastern Europe were chiefly concerned in such pacts. With these might also be grouped the various compensation or clearing agreements, since their purpose was likewise to avoid direct payment for the goods exchanged.

(b) *Debts and Defaults*

The universal heightening of barriers to trade immensely aggravated the problem of international debts. The efforts of the debtors to meet their obligations were largely frustrated by the obstacles put in the way of their exports by the creditor countries. The debtors were thus forced to deflate further and raise their own barriers to imports higher; but these measures, being mutually combative, were doomed to failure, and the next stage, which was reached, generally speaking, in the

latter half of 1931, was characterized by the failure of the debtors to meet the service of their debts in full, the establishment of Standstill Agreements limiting the withdrawal of short-term credits, and the defaults of Governments on the service of public debts. How much worse the tale would have been had not President Hoover intervened with his plan for a year's moratorium on inter-governmental debts arising out of the War, it is possible only to guess.

Naturally the fall in prices aggravated the difficulties of the debtor countries, who were forced to find a steadily growing volume of exports in order to pay a constant debt in terms of money.

'By the beginning of 1932, the average fall in gold prices in those countries which had adhered to the Gold Standard was about 30 per cent. from the levels ruling in December 1929 or 30–35 per cent. from the average of that year. . . . If those commodities which are the subject of competitive trading by well-informed buyers and sellers in organized world markets are taken, the fall is much greater. . . . Their gold prices dropped in this period by 55–60 per cent.'[1]

As far as debtor countries were concerned, even this estimate might not represent the full measure of their difficulties, because the prices of their products, being mostly raw materials and foodstuffs, fell faster than those of the manufactured articles that they had to buy; but even the lower figure of 55 per cent. for the drop of gold prices in less than three years would mean that the volume of exports needed to yield a given sum in gold currencies increased by over 120 per cent. between 1929 and 1932. It is small wonder, under the circumstances, that many countries, especially those whose debts were expressed in terms of gold-standard currencies, found it impossible to meet their international obligations for interest and sinking fund in full, whether on public or on private debts.

According to the Economic Section of the League of Nations, from September 1931 to July 1932 (this being the critical period of governmental defaults), the following countries established moratoria on their external public-debt service: Brazil (September), Bolivia (October), Hungary and

[1] *World Economic Survey, 1931–2* (League of Nations, Geneva, 1932).

Uruguay (December), Chile and Salvador (March), Greece, Latvia, and Jugoslavia (April); and the following countries established official moratoria on the service of external commercial debt: Uruguay (September), Germany (February), Chile, Salvador, and Jugoslavia (March). Apart from the countries mentioned, Bulgaria found it necessary to restrict releases of exchange for the discharge of commercial debt, and to suspend partially the transfer of the service of the public debt into foreign currencies; and Austria imposed, in May 1932, a general transfer moratorium applicable to all external debts and affecting temporarily even the League Loan of 1923.

Germany.

After protracted negotiations, a new German Standstill Agreement was signed in January 1932, prolonging for a further twelve months, with certain modifications, the agreement that was due to expire on the 29th February 1932. Certain types of commercial credits were included that had previously escaped. New opportunities were given to short-term creditors to exchange their credits for long-term investments, under guarantee that such investments would be retained in Germany for a period of years. As far as reimbursement credits were concerned, every foreign bank would have the right to demand a 10 per cent. reduction on the 1st March 1932 by means of the extinction of unused credit lines. The amount and time of further repayments would be considered in the light of the foreign exchange situation, every three or four months, by representatives of the creditor banks, the Reichsbank, and the various debtors.

The first of these conferences between debtors and creditors was held in London from the 1st to the 5th July 1932. Arrangements were made to ensure that the preferential reduction of 10 per cent. of all credits, which had not yet been fully carried out, would be completed by the end of the year. Outside the official agenda, the possibility of a reduction of interest rates was discussed. There had been considerable agitation in Germany for such a reduction, in view of the easy money conditions generally ruling in creditor markets, and indeed the Reichsbank was refusing to release foreign exchange for

payment of interest in excess of 7 per cent. The rate payable on the rediscount credit that had been granted by the other central banks to the Reichsbank was reduced early in the year to 6 per cent., and this the German authorities urged should be regarded as the normal maximum. According to the German press, in April 1932 the English banks were already charging 6 per cent., the Dutch, Swiss, and American 7 per cent., and the French 8 per cent., as a rule, on their respective standstill credits. At the July Conference it was agreed that the delegates should recommend to the bankers' committees in their respective countries the application to German credits of a lower schedule of interest rates. Political and financial agitation for further reductions, however, continued in Germany, and at the next conference with the creditors, in January 1933, the latter consented to accept still lower rates. Apart from the vexed question of interest rates, the Standstill Agreement worked quite satisfactorily, the chief improvements desired by the creditors being fuller rights to demand repayment of individual debts in marks, in order to liquidate bad debts, and a corresponding extension of liberty to reinvest in Germany the 'blocked' marks thus made available.

These issues were prominent in the negotiations for the renewal of the Standstill Agreement which took place in Berlin in February 1933. As a result of the agreement then signed, any creditor would have the right thenceforward to demand repayment of his debt, in reichsmarks and in quarterly instalments, to the amount of 50 per cent. in the case of cash credits and between 10 and 30 per cent. in the case of commercial credits. The reichsmarks must be invested in Germany for at least five years, or they might be used for financing 'additional' exports or tourist traffic. The creditors also obtained a general repayment of a further 5 per cent. of outstanding credit lines, while in return further interest reductions averaging ½ per cent. were to be recommended to the several national bankers' committees. By this time, that is to say, about a year and a half since the signature of the first Standstill Agreement, the volume of the debts covered by the standstill had been reduced to three-quarters of its original amount of approximately Rm.5,000 millions (£250 millions). From time to time,

furthermore, the Reichsbank had effected partial repayments of its international central banking credit of $100 millions, which had been periodically renewed, not without considerable disagreement between creditors and debtor regarding the conditions imposed. In April 1933 the whole of the outstanding balance of the credit was repaid, but as the operation was effected only at the cost of a great depletion of the Reichsbank's reserves it may be legitimately regarded as mainly a political gesture.

Another move in the consolidation of German short-term indebtedness was made when a Standstill Agreement, covering the short-term debts of German public bodies, was signed in Berlin on the 9th April 1932 by representatives of the debtors and of English, Dutch, Swedish, and Swiss banks. The agreement covered foreign credits to a total of Rm.247 millions. It provided for a 'standstill' until the 15th March 1933, an immediate 10 per cent. repayment, and interest at 6 per cent. subject to a minimum of 2 per cent. above current bank-rate in the respective countries. The creditors should have the right to denounce the agreement if for any reason the Standstill Agreement for private short-term debts should cease to hold good.

In the course of the year several German public debtors were forced to default on the service of their debts, but this was primarily a matter of internal finance, not of difficulties with the provision of foreign exchange. On the 1st January 1933 there occurred the first instance of default on a German public loan raised abroad. The seven biggest cities of the Bavarian Palatinate, which had created a collective twenty-year 7 per cent. loan of $3,800,000 in 1926, found themselves unable to provide the sum of Rm.600,000 required for the amortization payment due on that date The failure of the Reich Government to intervene in the interests of German credit abroad was particularly regretted in German financial circles. It may be guessed, however, that the central authorities were not unwilling to accept any opportunity of relief from the necessity of providing foreign exchange, since the strain upon the exchange resources of the Reichsbank was proving very severe. According to the Institut für

Konjunkturforschung, Germany earned in 1932 a surplus of Rm.1,100 millions (£55 millions at par) on her foreign trade, and £10 millions from services, but she had to pay out £40 millions more than she received in interest[1] and £10 millions on reparations account, leaving only £15 millions available for capital redemption. An additional sum of about £12½ millions was taken from the gold and foreign exchange holdings of the note-banks, making a total of £25 millions to £30 millions released for capital repayments abroad during the year.

The following year brought no improvement. In the first six months of 1933 the gold and foreign exchange reserves of the Reichsbank fell from Rm.920 millions to Rm.274 millions. A large part of the reduction was due to the repayment of the Reichsbank's international rediscount credits. On the 8th June 1933 Germany announced a partial moratorium on her long-term debt payments to foreign creditors. At the end of June representatives of the creditors met Dr. Schacht in London and Berlin to discuss the conditions of the moratorium, and the following terms were agreed upon, to take effect from the 1st July:

1. The interest and amortization on the Dawes Loan, and the interest on the Young Loan, would be transferred in full.
2. Amortization payments on the Young and other loans would not be transferred.
3. Half, but at most at the rate of 4 per cent. annually, of all coupon and other revenue payments falling due would be transferred.
4. For untransferred revenue payments, the creditors would receive negotiable bonds of the Konversionskasse.
5. Mark payments for amortization would be booked to the credit of the payee at the Konversionskasse.

Though this was not stipulated in the agreement, the 50 per cent. of the interest that was transferred did not comprise the

[1] Since the equivalent net interest payment in 1931 had been £65 millions, the reduction of the interest burden through falling money rates and through progressive redemption of capital was almost precisely equal to the total of capital repayments effected during 1932.

whole cash payment receivable by the creditors. The scrip delivered in lieu of the remainder was accepted by the Golddiskontbank at one-half of its face value, converted into foreign currencies. Thus the creditor who took advantage of this offer obtained in practice 75 per cent. of his interest. The Reichsbank, having received the full amount of interest in reichsmarks from the debtor, secured a considerable exchange profit, out of which 'additional' exports were subsidized; the exporter had first to prove that at the official rates of exchange he would be undercut by a foreign competitor at the lowest price that his costs allowed. This device had exactly the same effect, as far as such 'additional' exports were concerned, as a depreciation of the reichsmark would have had, but the consequences for the creditors were of course quite different.

The system of financing exports with scrip purchased at a discount was not generally resisted by Germany's creditors until it gave rise to discrimination among them. By reason of the special facilities allowed to German trade by Switzerland and the Netherlands, creditors in those countries were able to obtain the full face-value of their scrip by presenting it to their clearing-houses. When, on the 14th November 1933, the Reichsbank summoned a conference with representatives of the creditors to consider the future terms of the transfer moratorium, the question of discrimination came instantly to the fore.

The conference opened on the 5th December, and closed two days later without reaching any agreement. The creditors had strongly expressed the view that transfer should continue at not less favourable rates than those actually in force. They based their claim on the fact that since the end of June, thanks to a rising surplus on Germany's external balance of trade, the reserves of the Reichsbank had risen from Rm.274 millions to Rm.408 millions. On the 18th December, however, Dr. Schacht announced that in future only 30 per cent. of the interest due would be paid in cash. On the assumption that scrip would continue to fetch 50 per cent. of its nominal face-value, this would give the creditors 65 per cent. of their interest in cash, instead of 75 per cent. Dr. Schacht claimed that the increase in the Reichsbank's reserves was illusory, the greater

part having been due to the operation of the law against the holding of illicit balances abroad. About Rm.74 millions monthly was required for the full debt service, whereas the export surplus from July to November had averaged only Rm.65 millions, of which a substantial part had been paid in the form of blocked marks, registered marks, and German bonds.

The decision to reduce cash transfers immediately aroused vigorous protests from the creditors, who pointed out that, whatever Dr. Schacht's calculations might show, Germany had found sufficient resources to buy up a large quantity of her own foreign bonds. Such transactions were highly profitable to her, the bonds having fallen to a big discount, largely as a result of her own actions. The British Government themselves made diplomatic representations, mentioning not only the reduction of transfers but also the discrimination in favour of Swiss and Dutch creditors, and the use of scrip to subsidize exports. The protest was accompanied by the warning that Great Britain might find it necessary, in default of a settlement, to institute a clearing system for her trade with Germany. The United States made similar official representations, but could utter no similar warning because the balance of her trade with Germany was very much in her own favour. Between Germany and the United Kingdom, on the other hand, there was a balance of some £5 millions annually in Germany's favour—nearly £11 millions after omitting re-exports and allowing for invisible items; whereas the total annual service of German debts to British creditors was no more than £7½ millions.

In fulfilment of his promise (given at the meeting of the 5th–7th December) that separate national agreements would not be concluded with the creditors without consulting them all, Dr. Schacht invited the long-term and medium-term creditors to meet him again at the end of January 1934. The Swiss and Dutch Governments, he said, had again requested the conclusion of separate agreements. The conference was attended by a much more cordial spirit than had marked the previous discussions. Agreement in principle was reached on the 31st January, to the effect that as from the 1st July 1934

the discriminatory agreements with Switzerland and the Netherlands were to end, and all creditors were to be treated alike. In compensation for accepting differential treatment for six months, the other creditors would be able to encash their scrip with the Golddiskontbank at 67 per cent. of its face value, and would thus obtain approximately 77 per cent. of their interest in cash.

The conference on long-term debt was followed by a conference between debtors and creditors under the Standstill Agreement. They had already met during the previous July, when the restrictions were first imposed on the transfer of long-term debt service, and the creditors had then recognized that certain guaranteed repayments could no longer be transferred. A further cut in interest rates was also agreed upon. At the conference of January 1934 the terms of the agreement concluded in February 1933 were renewed for a further year, to the 28th February 1935, with only minor amendments. A general reduction of credits, such as was provided for in the agreements of 1932 and 1933, was not again negotiated. The amount of credits outstanding, indeed, had already been reduced to proportions that no longer placed a severe strain upon the liquidity of the creditor banks. From Rm.6,300 millions at the time of the first standstill in June 1931, they had fallen to Rm.2,600 millions, which was actually less than German indebtedness on short-term account had been in 1913. The outstanding amount included about Rm.270 millions of open credit lines of which the debtors had not yet availed themselves; there was some discussion at the February conference of the question whether this margin ought not to be reduced. The German debtors' committee, however, gave an assurance that the unutilized credits would be used only 'as a reserve of credit facilities available for the expansion of Germany's international business'.

On the 8th March 1934, as a result of still another conference with the creditors, the Standstill Agreement for the debts of *Länder* and municipalities was also prolonged for the period of one year, on the same general terms as before. The creditors obtained the option to convert the whole of their credits into 4 per cent. twenty-year reichsmark bonds, which might be

sold in exchange for 'registered marks'. In this case also, the total of debts outstanding had fallen considerably, from Rm.247 millions at the date of the first agreement to Rm.148 millions. It must not be supposed that the reduction of the outstanding amounts of short-term debt, under either Standstill Agreement, was entirely due to redemption in foreign currencies. A large part had disappeared from the scope of the agreements through being converted into 'registered marks', which represented a convenient form of reinvestment in Germany, or which might be sold, at a heavy discount, for foreign currencies. Still further reductions had been effected by the depreciation of the pound and the dollar, in which many of the debts were expressed. This factor also applied to the long-term debts. Nevertheless, considerable repayments had been effected, giving rise to the accusation that Germany was able to buy up her own bonds at bargain prices while feigning inability to pay the full interest.

Austria.

In Austria the affairs of the Credit-Anstalt continued to play a vital part in the country's external financial relations. In November 1931 the Austrian Government concluded an agreement with the representatives of the foreign creditors for the complete reorganization of the bank. The scheme was modified in the course of its passage through the Federal Parliament, with considerable reduction in the economies that were to have been effected in working expenses. In May 1932 the Government offered to pay off the creditors in forty annuities representing between 20 per cent. and 30 per cent. of the debts, but this proposal proved altogether unacceptable. However, later in the year an agreement was initialed, exchanging share capital in the bank and Government obligations for the old Credit-Anstalt debts, and providing also for strong co-operation between the foreign creditors and the management of the bank. In its report of January 1933 the Financial Committee of the League of Nations pointed out that the problem of reducing the working and administrative costs of the Credit-Anstalt and the other Austrian banks was still very urgent.

Meanwhile, the general external economic position of Austria was deteriorating. In view of the drain on the foreign exchange resources of the National Bank, a system of control of foreign exchange transactions was instituted in October 1931 and was gradually tightened up. Nevertheless, the reserves continued to drop, and in the middle of 1932 the gold and foreign exchange of the National Bank totalled only £5,500,000 (gold) against £24,600,000 (gold) fifteen months previously. In January 1932 the National Bank notified certain creditors of Austrian concerns that it could not undertake to supply foreign exchange for the repayment of the principal of short-term credits. The Financial Committee of the League of Nations, recognizing the inevitability of this move, recommended extension of the veto to all such short-term payments, coupled with the conclusion of a new Standstill Agreement with the foreign creditors. The last part of the proposals proved very difficult to achieve, but was eventually carried out.

On the 9th May the Government of Dr. Dollfuss, which had just succeeded the Buresch Administration, addressed a note to the League of Nations calling attention to the scarcity of foreign exchange and urging that the League should advise whether exchange should continue to be allotted for the service of external debts. The foreign exchange assets of the National Bank, explained the Chancellor, at that time consisted almost wholly of the credits granted by the Bank of England and the Bank for International Settlements, and it would be contrary to the understanding on which the credits were granted to allow the reserves to become exhausted. Moreover, it might prove impossible to obtain even those imports absolutely necessary for the population of Austria. The League Council, in reply, expressed itself generally in favour of a relief loan to Austria, and referred the plea to the Mixed Committee of Treasury representatives and members of the Financial Committee. At the end of May the Italian Government instructed their Ambassadors in London, Paris, and Berlin to call attention to the serious plight of Austria and to urge that the international consideration thereof be accelerated. On the 23rd May the Austrian Government decided that the transfer of

debt service must be suspended, and from the 23rd June no releases of foreign exchange for settlement of obligations for interest or amortization were made by the National Bank. This applied to all debts alike, including the League Loan of 1923, but it must be noted that a reserve fund for the payment of interest on that loan was available, under the terms of the international statute; and that the Austrian Government had provided the currency for the repayment of principal a year in advance, so that the instalment of sinking fund due in December 1932 was already in hand. Furthermore, the transfer of the monthly instalments for the service of the League Loan was resumed in January 1933, and the coupon of the 1930 Investment Loan, on which no default had yet occurred, was also paid then in foreign currencies.

The status of the Standstill Agreement was obviously modified by the transfer moratorium. Between the end of August 1931 and the 20th January 1932, when the original Standstill Agreement expired, over one-half of the short-term banking debts, amounting to 33,687,000 schillings, had been repaid. The agreement that replaced the original one after that date had provided for a cessation of capital repayments, and between the 20th January and the end of June the amount outstanding had been reduced only from 16,046,000 schillings to 15,214,000 schillings. Negotiations for the renewal of the agreement, which again expired on the 20th July, were successful only in securing an agreed postponement of capital repayments until January 1933. Meanwhile there had been other still more important developments.

A special meeting of the Mixed Committee, to which Austria's appeal for financial succour had been referred, was held at Lausanne during the Reparations Conference. Discussion in the Committee turned upon two issues: the reluctance of the British Government to incur any financial commitments in respect of international loans, and the insistence of the French Government that the loan should be conditional upon a reaffirmation by Austria of the terms of the protocol of the 1923 Reconstruction Loan, which, according to the judgement of the Hague Court, legally prevented economic as well as political *Anschluss* with Germany.

Eventually a protocol was signed by the representatives of all the interested Powers except Germany herself. A loan of 300 million gold schillings, redeemable over twenty years, during which period the terms of the protocol would remain in force, was to be raised under the following guarantees: United Kingdom, 100 million schillings; France, 100 million schillings; Italy, 30 million schillings; Belgium, 5 million schillings; Netherlands, 3 million schillings; the remainder to be guaranteed by other countries who, it was hoped, would participate in the flotation.[1] The British portion, however, represented no new money, but merely a conversion of the 100 million schillings lent to the Austrian National Bank by the Bank of England during the crisis of June 1931. The proceeds of the loan, apart from that, would be used for the restoration of Austrian national finances in agreement with a League Commissioner and a League adviser to the National Bank. Besides returning to international financial control, which had been terminated in 1926, Austria abjured again, in the terms of the 1922 protocol, all efforts to alienate her independence.

It was this latter clause which nearly prevented the ratification of the agreement. Germany straightway refused to adhere, while making an independent offer of a credit for the Austrian Government. Bitter opposition was raised in Austria itself, and the Bill ratifying the agreement was passed—and passed again after the Federal Council had actually rejected it—by extremely narrow majorities in the National Assembly, against the combined opposition of the Pan-Germans and the Socialists. Most remarkable was the criticism of Monsieur Flandin during the debate on the ratification Bill in the French Chamber. Monsieur Flandin, who had been Finance Minister in the Governments of MM. Laval and Tardieu, declared that France was exposing herself to the accusation that she had bought the liberty of the Austrian people for 300 million francs. A critic still further to the Right, Monsieur Marin, said that Austria was already under obligation to refrain from pursuing the *Anschluss*; yet it was being built up daily and the financial pressure of France would not prevent it. Monsieur

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Herriot's defence was that there were only two alternatives: the *Anschluss*, which would incorporate Austria in a great German union, or the policy of the League, which would give Austria moral and political independence in an organized Europe. Monsieur Viénot, expressing the majority views of the Foreign Affairs Committee of the Chamber, was more candid. If, he declared, France was to say 'No' to Austria when she entered upon dangerous political courses, she must say 'Yes' when Austria asked for help in meeting French wishes.

Before the Finance Committee of the French Chamber, Monsieur Chéron, Minister of Finance (who, however, admitted that the loan was more important for France from the point of view of foreign policy than from that of pure finance), pointed out that, if Austria were not put in the way of providing the service of the 1923 loan, the French Treasury might have to back its guarantee of that loan to the extent of 750 million francs in ten years. A similar consideration, of course, exercised the minds of other participating Governments. But it is remarkable that support for the loan was very lukewarm in London financial circles; the view that the loan would prove inadequate to restore Austrian finances to a condition in which transfers could be resumed and the exchange maintained without further foreign aid, and that something much more drastic was required, was forcibly expressed both in London and in Austria itself.

In spite of these criticisms from such widely different quarters, the terms of the loan were ratified, as required, by Austria, Great Britain, France and Italy before the end of the year. There was, however, some delay before the loan could be floated, since the necessary financial measures had to be passed through the Parliaments of the guarantor states. No public issue for the loan was made until August 1933, when the London and Paris *tranches* of the loan were issued independently. The London issue was oversubscribed and went immediately to a premium.

Hungary.

After the failure of the Austrian Credit-Anstalt in May 1931 there was a swift withdrawal of foreign credits from Hungary,

accompanied by signs of waning internal public confidence in the national currency. Extraordinary measures of financial defence were thereupon enforced. A three days' bank holiday was declared in July, and the withdrawal of bank deposits was temporarily limited. All foreign exchange transactions were centralized at the National Bank, while at the same time the declaration to the Bank of all liabilities and assets in foreign currency was made compulsory. To begin with, restrictions were placed on releases for payment for imports, but not on those for settlement of interest or sinking-fund accounts; under this régime, however, a slow but steady drain of foreign exchange reserves took place. In October 1931, in response to a request by the Hungarian Government, a delegation of the League's Financial Committee examined and reported on the financial situation of the country.

The Hungarian Government were induced to declare to the Financial Committee their determination (*inter alia*) (*a*) to re-establish Budget equilibrium; (*b*) to transfer certain of their industrial undertakings to private hands; (*c*) to ask the Financial Committee to appoint a representative to reside in Budapest until the League Council should be satisfied that the financial stability of Hungary was assured; (*d*) to abandon their efforts to maintain artificially the domestic price of wheat; (*e*) to revise the general banking legislation in consultation with a representative of the Financial Committee; (*f*) to take steps to avoid excessive borrowing by local authorities and others in the future. The Financial Committee described the steps proposed as eminently desirable, but they recommended that budgetary expenditure be cut still further. The Committee declared that while the direct total indebtedness of the state could not be considered excessive, the debt of the whole community of Hungary had been increased in the past six years at a rate which the real needs of the country did not warrant. They admitted that time and effort were required to open new channels of trade in order to make up for the alteration of financial movements, and that Hungary was subject to special difficulties through her reliance on wheat exports (which, with wheaten flour, had formed one-fifth of her total exports in 1929); but they expressed considerable

optimism regarding Hungary's capacity to create and maintain an active balance of trade.

In the opinion of the Committee it was essential that the stability of the pengö should be maintained, but if this was to be done, and foreign obligations for interest were to be met, then exchange operations must be so controlled as to restrict imports to an indispensable minimum. Such a restriction of imports implied in its turn a contraction of internal credit, in the absence of which a rise of prices would be inevitable. While they urged the conclusion of Standstill Agreements for short-term debt, they considered that Hungary should make every effort to meet the service of her long-term foreign debt in full.

For some months the efforts of the National Bank and the Government to pay the service of the external debt were continued, but the supply of foreign exchange began to prove inadequate. On the 23rd December a decree was promulgated embodying a partial, and potentially a total, moratorium on the transfer of external debt payments into foreign exchange. The amounts becoming payable on all debentures and bonds, as well as on the interest of Treasury bills issued by the Hungarian state, might not be paid to foreign creditors, but must be deposited in pengö at the National Bank. Amounts so deposited would be remitted to a special foreign creditors' fund, in so far as transfer into foreign currencies could not be executed 'without endangering the continuity of the country's economic life or other vital interests'.

In an accompanying *communiqué* the Hungarian Government declared that they proposed to apply the foreign currency at their disposal in the first place to the service of the 1924 League Loan, and then, so far as the supply of foreign exchange permitted, to the service of other debts in specified order of priority. Further, foreign currency would be granted for the purpose of meeting interest or discount and commission on short-term debts to bankers and others, and of giving effect to standstill arrangements with the different short-term creditors.

Protracted negotiations were conducted with the short-

term creditors during the next six months. At the beginning of March 1932 a Standstill Agreement was reached with the British creditors, according to which interest and commission on the short-term debts would be deposited for the time being in pengö. Guarantees were given that Hungary would follow a foreign exchange policy (for instance in respect of clearing agreements) that would render it impossible for preference to be accorded to any particular group of creditors. Prolongation of maturities was to continue on these terms until the 1st August 1932. A similar agreement was reached with representatives of the American banks concerned at the end of June. Extensions of these arrangements were subsequently negotiated. It was estimated that the total foreign short-term indebtedness of the Hungarian banks was about £22 millions, of which about £7 millions were owing to American and £4 millions to British bankers.

In spite of these measures there was a further fall of the exchange reserve. By May 1932 it had fallen so low that the National Bank was unable to transfer the monthly instalments of League Loan service, and at the end of June the trustees of the loan announced that the funds in foreign currencies then in their hands were insufficient to meet in full the interest due on the 1st August. Shortly afterwards the assigned revenues (except the pengö equivalent of the non-transferred service dues) were removed from the trustees' control. As had happened with the Austrian League Loan, certain funds were already available for maintaining the service of the Reconstruction Loan for a while. On the 4th August the Hungarian Government issued a statement acknowledging the importance of preserving the status of the loans issued under the auspices of the League of Nations, and suggesting that the interest service could be maintained if the trustees of the loan were to apply the reserve fund to meeting the coupons before providing redemption. On this basis the Government expressed the confident hope that they would be able to provide the foreign exchange required to meet the coupons up to and including the one due on the 1st August 1933.

Meanwhile, the balances of pengö due for exchange into

foreign currencies but not transferred were piling up. The foreign creditors' fund had not been invested, although interest was being paid on accumulated balances. The authorities in Hungary were pursuing a comparatively liberal internal credit policy, the bank rate being reduced progressively to 5 per cent. from a maximum of 9 per cent. in July–September 1931; consequently, internal prices showed a decline in no way comparable with the big drops in the price indices of other countries. By the 30th November 1932 the Hungarian State Government were over 18 million pengö in arrears on their obligations to the foreign creditors' fund, and later they ceased altogether to transmit to the fund the pengö equivalent of the service of the external public debt, pleading the inability of the Treasury to find the money.

Hungary's estimated annual indebtedness of 300 million pengö for interest and other debt service may be compared with exports, in 1932, of 332 million pengö, and imports of 337 million pengö. Thus unless prices were to rise, or Hungary's exports were to increase substantially in volume, the maintenance of full debt service would have required that imports should be cut down to negligible amounts, in fact far below the total of indispensable raw materials. Hungary's trade was, of course, being choked by the restrictive policies of her neighbours induced by their own financial troubles, and in an attempt to mitigate her difficulties she adopted the policy of concluding clearing agreements with them. By October 1932 she had signed clearing agreements with Austria, Belgium-Luxembourg, Czechoslovakia, France, Germany, Italy, Rumania, and Switzerland, which countries took, at the time, over three-quarters of Hungary's exports. The League representative, reviewing the results of these agreements up to the 30th September, described them as deplorable, and the agreements themselves as defensible only on the ground that, without them, Hungary's trade with the countries in question would have ceased altogether. The Hungarian Finance Minister, describing the Government's economic policy early in 1933, made an exception in favour of the clearing agreement with Austria, which, he said, was working satisfactorily.

Bulgaria.

At the meeting of the Financial Committee of the League during the first fortnight of March 1932 the Bulgarian Government pressed for the immediate grant of financial reliefs, as they found themselves otherwise unable to meet the instalment of their external debts due on the 15th March. This crisis however, was the conclusion of a sequence of gradually increasing financial difficulties. As early as January 1931 the Financial Committee, which had a special interest in Bulgaria on account of the administration of the Refugee Loan of 1926 under League auspices, and of the existence of other international controls, reported that the Budget situation called for the closest attention on behalf of the Bulgarian Government. The other aspect of Bulgaria's financial troubles, the problem of external transfer, had also raised acute difficulties. Even after the stabilization of the leva in December 1928 with the aid of a 'League' loan, complete freedom of trade in foreign exchange, which had been subject to regulation since 1923, was not restored, and on the 15th October 1931 monopoly control over such transactions was once more vested in the National Bank. This action, involving a ban on luxury imports and the strict curtailment of transfers for the settlement of short-term and commercial debts, was taken under pressure of a considerable loss of exchange. During 1927 and 1928 and the beginning of 1929 there had been a progressive influx of private short-term credits of every description. In the second half of 1929 the movement was reversed, and during 1930 and 1931 there were extensive withdrawals. During the course of 1931 the reserve of the National Bank fell from 2,661 million leva to 1,768 million leva in spite of a surplus on the trade balance officially placed at 1,274 million leva.

In the opinion of the League's Financial Committee (reporting on this situation in January 1932) it was important that the public should realize that bank reserves were designed to meet periods of exceptional difficulty and need not, in consistency with sound central banking usage, be regarded as entirely unavailable. In cases of necessity, and until conditions should improve, some part of such reserves could safely

and properly be used. On the other hand, it was imperative that every step should be taken to secure to the National Bank complete control over operations in foreign exchange. Two months later the Committee calculated that in view of the rigorous restrictions placed on imports by Bulgaria's principal customers in Central Europe, her average credit balance in foreign exchange, arising from commercial transactions, could not exceed 100 million leva per month, against which there was a debit balance of at least 10 million leva in respect of invisible imports. Apart from commercial or banking debts, transfers for the public debt service averaged 91 million leva per month, including 22,300,000 for reparation payments. The Committee, in short, concluded that Bulgaria was unable to meet all the transfer obligations which she had contracted. They recommended that transfers for the whole of the service of the external public debt should be reduced by 50 per cent. during the six months April–September 1932. The Bulgarian Government should continue to enter amounts not transferred in their Budget and to pay those amounts in leva into a special blocked account, which might be temporarily invested in Bulgaria. A similar effort at restriction would naturally be required in respect of private indebtedness.

The recommendations were carried out, and a provisional agreement come to between the Bulgarian Government and groups of the external public debt bondholders. In November 1932 a further agreement, providing for a reduction of the transferred portion of the service of the two League Loans, was negotiated in London. The position, however, deteriorated quickly owing to the rapid fall in the value of Bulgaria's exports and the compulsion under which she was placed to accept commercial agreements with a number of countries, limiting releases of exchange from the proceeds of trade with those countries. Total exports of merchandise during 1932 amounted to £4,700,000 (gold), and imports to £6,800,000,[1] so that instead of a surplus of foreign exchange available for debt service there was actually a deficit to be met.

[1] Issues of foreign exchange by the National Bank, however, totalled only £5 millions, indicating that about £1,500,000 worth of goods had been imported on credit.

Greece.

The post-War economic situation of Greece was dominated by the necessity of providing for the thousands of refugees who streamed into the country from Asia Minor and elsewhere during and after the Greco-Turkish war. To begin with it was a question of providing these unfortunate people with the barest elements of subsistence, shelter, and sanitary and medical service, but when that had been done the Government, under international advice, embarked on a large programme of public works, notably irrigation projects, designed to render the greatly increased population self-supporting and eventually to minimize the country's need to import considerable quantities of essential foodstuffs. Loans for purposes of refugee settlement and financial stabilization were raised under the auspices of the League of Nations in 1924 and 1928, and their service, along with that of certain other state indebtedness, was administered by an International Financial Commission representative of the Governments of Great Britain, France, and Italy. Further international supervision existed in the person of a League adviser to the Bank of Greece, the statutes of which were promulgated in conformity with an international protocol signed at Geneva in 1927.

As into other Central and Eastern European countries, capital poured into Greece from 1925 to 1928, establishing a large inward balance of trade—although in Greece a considerable volume of 'invisible exports', chiefly shipping services, tourist traffic, and the remittances home of former emigrants, offset some of the excess imports of merchandise. Although the merchandise deficit was progressively reduced from 1929 onwards, the cessation of foreign lending, the anxiety of investors to remove their money from a country whose immediate economic future seemed precarious, and the low price of Greece's exports (chiefly tobacco and currants) caused a severe and rapid depletion of reserves of foreign exchange. On the 28th September 1931 restrictions were imposed on dealings in foreign exchange, and the Bank of Greece proceeded to limit the amounts allotted for purchase of imports. Even this measure did not prove effective in

checking the drain of exchange, and in the last quarter of the year the reserves of the Bank fell still more rapidly.

It was under these circumstances that the Greek Government and the Bank of Greece, in January 1932, invited the Financial Committee of the League to study the financial position of the country. At the same time the Prime Minister, Monsieur Venizelos, addressed to the three Governments represented on the International Financial Commission in Athens a request (1) for the suspension of external sinking funds, and (2) for support for further foreign loans to complete the irrigation programme in the valleys of the Struma and the Vardar. These two requests were the basis of the proposals laid by the Greek Government before the Financial Committee at its March meeting. By that time the total foreign exchange resources of the Bank of Greece had fallen to 1,275 million drachmae, which was almost exactly equal (at the Committee's reckoning) to the annual service of the foreign public debt of Greece. This huge obligation stood in face of an external trade account which scarcely balanced even at the highest reckoning of invisible items. There was also a troublesome Budget problem; for 1932–3 there was a prospect of a deficit of 1,300 million drachmae, which the utmost economies yet proposed by the Greek Government would not reduce below 400 million drachmae. Further, irrigation works in hand, which were not included in the Budget, would require approximately 1,000 million drachmae in 1932–3.

Nevertheless, in their report of March 1932 the Financial Committee declared that of the two problems, the transfer problem and the Budget problem, the former was undoubtedly the more urgent. They regarded it as impossible for the Greek Government to maintain in full the transfer service of their foreign debt. They felt obliged to recommend that, for the period of one year (as compared with the five years of the Greek project), the transfer of the sinking funds of all Greek external loans should be suspended. The Committee felt unable, 'in this particular instance', to urge any separate treatment for the League Loans of 1924 and 1928. The Greek Government, however, should maintain full payment in drachmae of the non-transferred amortization. The

Committee suggested that, except where creditors were willing to be paid in drachmae to be retained in Greece, the drachmae amounts should be paid over to the International Financial Commission, though they might be re-lent temporarily to the Greek Government for unavoidable expenditure on existing irrigation schemes. The Committee held that the steps taken to reduce and control imports, and the reduction of Government expenditure abroad other than debt services, together with the recommended cut in foreign sinking funds, would enable Greece to maintain the interest service of the public debt. At the same time, it was a matter of urgent importance that Greece should be included in a general scheme for the raising of guaranteed loans under international auspices.

Pending a direct settlement with representatives of the bondholders, the Greek Government refused facilities for the transfer into foreign currencies of the sums in drachmae retained by the International Financial Commission. This policy was the subject of formal protest by the three Governments represented on the International Commission—Great Britain, France, and Italy. It was not until September that the Greek Government reached agreement with representatives of their creditors. While the debtor Government recognized their full liability, they could not, they declared, find means for providing the service of the sinking funds of the external loans, nor meet more than a limited amount of interest charges during 1932-3. Payments amounting to 30 per cent. of the total annual interest service on each loan would be made in foreign exchange. These arrangements were recommended to bondholders by the Council of Foreign Bondholders and by the League Loans Committee.

After some delay, due to the failure of the Greek Government immediately to complete their undertaking to pay 30 per cent. of the annual interest service, and to disagreement over the question of releasing for the benefit of the Greek Government the blocked sums in drachmae in the hands of the International Financial Commission, the agreement was put into effect in January 1933. In the interim, no releases of exchange were made for the service of the state debt; but the service of private long-term debts was met in full, together with

the interest on private short-term commercial debts. Repayment of the latter, however, was restricted to the grant of foreign exchange every six months to the extent of not less than 10 per cent. of the total debt.

Meanwhile, important changes had occurred in the external economy of Greece. On the 23rd April 1932 the gold standard was abolished. At the same time, the system of exchange control was reinforced. The importation of goods other than cereals, animal products, and foodstuffs was severely restricted. Greece was the only one of the debtor countries of Central and Eastern Europe to allow the formal depreciation of the external value of her currency, the nearest instance being Austria, where an unofficial or 'black' market, on which the schilling sold at a considerable discount, was recognized alongside the official market on which the schilling retained its former par value. The comparatively great importance of the British market to Greece, and the fact that a large part of her external indebtedness was expressed not in gold but in sterling, differentiated her from other Balkan countries and helped to explain her decision, contrary to theirs, to abandon the gold standard. By the end of the year the drachma had depreciated to less than one-half its par value in dollars, so that sterling itself stood at a high premium in terms of drachmae.

The League Loans.

The part played by the financial and economic organization of the League of Nations in promoting the financial restoration of Europe, ever since the first attempts at stabilizing the Austrian currency in 1921, was the object of considerable applause by supporters of the League. By the middle of 1932, however, apologists might have been excused for doubting whether, on the whole, the League had gained prestige by participating in financial reconstruction. Of the six large loans issued under the auspices of the League, transfer of service had been altogether suspended at that time as regards the Austrian and Hungarian and the two Greek loans, while only 50 per cent. of the service of the Bulgarian loans was being furnished to bondholders. It was therefore natural that these

defaults should have redounded, in the public mind, to the discredit of the League's financial organization.

Nine loans, totalling approximately £80 millions in nominal value at pars of exchange, were issued between 1923 and 1928 on the basis of schemes recommended by the Financial Committee of the League and approved by the Council. In most cases the issue of the loan was made conditional upon the acceptance by the debtor Government of some form of supervision over its finances by League representatives, as well as the assignment to international trustees of specific revenues from which the service of the loan would be met. Thus apart from any moral responsibility, which might be imputed to the League, for securing the recognition of a special status for these loans, they were rendered attractive to the investor by the certification of the League that the scheme of financial reconstruction or refugee settlement was a sound one, by the allotment of sufficient revenues amply to cover service, and by the continued concern of the League in the internal finances of the borrowing countries. The result was that—in so far as comparison is possible—these League loans seem to have commanded a higher price than similar governmental loans

League Loans

(£ millions at pars of exchange)

Loan	Total issue	Countries of issue: Great Britain	U.S.A.	Other countries
Austrian 6% Guaranteed Loan, 1923	32·0	14·0	5·1	12·9
Bulgarian 7% Refugee Loan, 1926	3·2	1·7	0·9	0·6
Bulgarian 7½% Stabilization Loan, 1928	6·2	1·5	1·8	2·9
Danzig (Free City) 6½% Tobacco Monopoly Loan, 1927	1·9	1·5	..	0·4
Danzig (Municipality) 7% Loan	1·5	1·5	..	..
Estonian 7% Banking and Currency Reform Loan, 1927	1·5	0·5	0·8	0·2
Greek 7% Refugee Loan, 1924	12·3	7·5	2·3	2·5
Greek 6% Stabilization and Refugee Loan, 1928	7·6	3·4	3·1	1·1
Hungarian State 7½% Loan, 1924	14·1	7·9	1·5	4·7
Total, nine loans	80·3	39·5	15·5	25·3

not issued under the authority of the League, while many of them admittedly could not have been raised at all but for the League's action. Above (p. 133) is a list of the loans showing the centres in which they were issued. It may be remarked that the place of issue does not necessarily indicate the ultimate source of the subscriptions; for instance, many blocks of League loans issued in New York and other centres were known to be held in London by large investors who were in a position to take advantage of minor differences of price between one centre and another. The high proportion issued in London becomes even more striking if the Austrian loan, which alone among them was guaranteed by external Powers, is omitted. Of the remainder, some 53 per cent. was originally floated in London.

The main reason why investors in these loans were disappointed of their expectations was a universal one—the great fall in prices which, accompanied by the cessation of international lending, made the burden of their debts intolerable for almost all debtor countries. In some measure, however, the fall in prices and the drying up of the stream of loan money served merely to unmask defects in the economies of the borrowing countries which would in any case have come to light eventually. In certain instances it seemed that the total annual obligations of the debtor country in respect of its whole external debt, private and public, exceeded any trading surplus which could be counted upon even in prosperous times; or that the internal economy of the country was based unduly on the indefinite continuance of loan works financed with money borrowed abroad. Sometimes the fault lay with the public finances—there was insufficient central control over public expenditure, or the Budget was established on such a scale that revenue was certain to be inelastic should it prove necessary to increase expenditure for emergency purposes. These were faults which were certainly not confined to the recipients of League loans, but critics were inclined to suggest that, had the investigation and supervision conducted by the League's financial organization been a little more insistent and longer maintained, public warning of danger might have been given earlier to the debtor Governments.

On the other hand, defenders of the League's financial organization urged that the international controls, which had been instituted for a definite limited purpose, were rightly terminated when that purpose had been achieved. They could not have been prolonged merely by reason of the possibility that fresh troubles might arise from fresh causes. The investor in League loans was assured only against certain risks, namely, the internal risks occurring during the execution of schemes, and in this assurance the League did not fail him.

In April 1932 a committee was formed in London, at the instance of the Bank of England, to protect so far as was possible the bondholders of League loans. Later the committee addressed memorials to the British Government and to the Council of the League of Nations. The memorials were dated the 18th July 1932, but they were not published until the 20th September. The committee, after reciting the list of loans, submitted to His Majesty's Government:

'That these loans were issued at various times since the War with the object of furthering the policy of European reconstruction, and that they were approved in detail by the Council of the League of Nations with the concurrence and support of H.M. Government, which was at all times represented on the Council. The fact that recourse was had to the League shows the difficulty, if not impossibility, of making such issues at the time solely by the normal market procedure.

'That it is believed that in all cases H.M. Government desired the success of the loans in the interest of their general policy of European reconstruction, and in more than one instance particularly recommended them to the support of the competent authorities of the City of London.

'That the British investing public, which subscribed about half the total of the League loans, did so in the faith that a special security attached to them, and that having regard to the circumstances of the issue both the Council of the League of Nations and H.M. Government would exercise a special watchfulness in regard to them.

'That the "League Loans" have a moral claim to special consideration in view of the facts that, but for the reconstruction schemes in connexion with which they were issued, the service of previous loans could in many cases hardly have been resumed, nor

would subsequent lenders have invested funds as they did in the countries concerned.'

In view of the defaults or infractions of general bonds which had already taken place on several of these loans, and of 'the deplorable effect on the influence of the League of Nations, both in financial and in other fields', which must be produced thereby, the committee prayed His Majesty's Government

> 'To move the Council of the League of Nations to take into immediate consideration the very grave situation which has arisen in respect of the loans issued under its auspices and subscribed on the faith of its approval, and the injury which these defaults or threatened defaults inflict on the prestige of the League and on its ability to aid similar reconstruction schemes in future; and
>
> 'To urge the Council to take such steps as will best serve to restore confidence in League issues and enable the League to continue its work of European reconstruction.'

The memorial to the Council of the League followed similar lines.

The Council, following the report of an *ad hoc* committee, accepted a resolution admitting the special responsibility which lay upon it in connexion with these loans, and reaffirming the very grave concern with which it viewed the continued failure of certain states to meet their obligations thereunder.

In the evolution of a technique of default on international debts, a highly important role was played by the Financial Committee of the League. The views expressed by the Committee were important, not only on account of their executive effect, but also because the Committee's personal composition indicated that these were the opinions of the most influential central and private banking circles in Europe. It is therefore of interest to review the principles that emerge from the sundry reports of the Committee.

1. For each of the four countries with which the Committee principally concerned themselves, at least partial suspension of transfer of the service of external public loans was declared inevitable. Suspension, however, was to be regarded as an extremely grave act, seriously damaging the credit of the debtor, and should therefore be treated as a strictly temporary measure.

2. It was impossible to lay down any universal rules for discriminating between one class of indebtedness and another, or between one kind of public loans (e.g. the League loans) and another.

3. One important consideration, however, was the necessity for maintaining a basis for commercial credit, on which external trade—the only means whereby any of the debts could ultimately be paid—depended. The Committee urged debtor Governments and banks to conclude Standstill Agreements with their short-term creditors.

4. Budgets must be balanced, chiefly by means of cuts in expenditure, and public finances generally put on a sound footing.

5. The sums due on external public debt but not transferred should be paid in local currency into a special account, which might be temporarily reinvested in the debtor country under special safeguards.

6. External depreciation of the currency would be highly dangerous. A restrictive internal credit policy should be employed to counteract the rise of prices otherwise threatened by the restriction of imports and the retention of non-transferred sums.

7. Control of foreign exchange operations, however regrettable, was a temporary necessity in order to build up a surplus of exports. The system, once in force, should be made as complete and strict as possible.

8. Endeavours to build up an export balance out of which to pay debt service were being frustrated by the conclusion of clearing agreements, which served merely to restrict trade.

9. Further international loans, guaranteed by creditor countries, were necessary if the debtors were to be set on their feet again.

10. The Committee throughout treated the financial crisis as a temporary phenomenon, and the measures recommended to meet it as essentially transitory. Their advice, up to the end of 1932, was that no final settlement should be contemplated by the debtor Governments, and their recommendations were in terms of the next six months or year at most.

V

INTERNATIONAL EFFORTS, 1931–3

(a) *The End of Reparations*

ON the 20th June 1931, in the midst of an acute financial crisis in Central Europe, President Hoover published his plan for a moratorium of one year on all 'inter-governmental debts, reparations, and relief debts, of course not including the obligations of Governments held by private parties'. The announcement had a swift and powerful psychological effect, which nevertheless wilted as the weeks passed while the European Governments looked this gift horse in the mouth. France was particularly exercised at the possibility that to scrap the machinery provided in the Young Plan for suspending the conditional reparations annuity, in the event of Germany's inability to pay, would be to scrap the whole Young Plan and indeed all reparations. It was not until the 11th August that a Seven-Power Conference, meeting in London, agreed upon the terms on which the President's offer would be accepted. The main principles of the London pact were that the suspended inter-governmental payments (including the conditional annuity due from Germany) should be repaid over ten years with interest not exceeding 3 per cent.;[1] that the unconditional reparation annuity should be nominally paid during the moratorium year, but that after deducting the service of the Dawes and Young Loans it should be returned to Germany by the Bank for International Settlements in the form of a loan to the German railways.

The Hoover moratorium obviously affected the various Governments very differently. Broadly, the United States forwent income (£53,600,000) for the time being, while Germany was relieved of outgo (£77 million). But the chief creditors for reparations also came out on the wrong side of the balance—France to the amount of £16,100,000 and the United Kingdom to the amount of £9,700,000; while Australia, New Zealand, Czechoslovakia, and a few other

[1] Afterwards increased to 4 per cent.

countries shared Germany's lot in enjoying a net relief during the moratorium year.

The moratorium agreements had scarcely been signed when it was time to consider what was to happen when they expired; for the financial condition of the world clearly forbade a sudden return to the complete régime of war debts and reparations. In October 1931 the French Prime Minister, Monsieur Laval, visited President Hoover in Washington, and a paragraph in their joint *communiqué* on parting read as follows:

> 'In so far as inter-governmental obligations are concerned we recognize that prior to the expiration of the Hoover year of postponement some agreement regarding them may be necessary covering the period of business depression, as to the terms and conditions of which the two Governments make all reservations. The initiative in this matter should be taken at an early date by the European Powers principally concerned, within the framework of the agreements existing prior to July 1, 1931.'

This was justifiably interpreted in France and elsewhere in Europe as implying that if the European Powers would settle the reparations problem, within the formal framework of the Young Plan, the United States would contribute her quota to a general settlement by a reconsideration of war debts. The hope was bitterly disappointed. From the vantage-point of history, however, we may compare the paragraph already quoted with another in which President Hoover and Monsieur Laval declared that they were

> 'convinced of the importance of monetary stability as an essential factor in the restoration of normal economic life in the world, in which the maintenance of the Gold Standard in France and the United States will serve as a major influence,'

and we may conclude that on many points American policy was passing through a phase of uncertainty and vacillation.

After much argument and delay, in November 1931 the German Government, acting under the terms of the Young Plan, formally applied to the Bank for International Settlements for the appointment of a Special Advisory Committee to consider Germany's ability to pay the postponable portion of her reparations debt. This Committee, meeting at Basle in December, agreed that it would not be possible for Germany

to transfer the conditional annuity in the year beginning July 1932. The experts pointed out that, so far from there having taken place the steady expansion of world trade which the Young Report had contemplated, the opposite had occurred, and that the exceptional fall in gold prices had greatly added to the real burden, not only of the German annuities, but also of all payments fixed in gold. Concerted governmental action was therefore called for in a much wider field than that of Germany alone, and an adjustment of all intergovernmental debts was vitally necessary.

There followed a period in which international misunderstanding flourished, while the economic background steadily darkened. In the United States, opinion was hardening against any further relief to the war-debtors, who were thought to be using the world economic crisis as an excuse for evading their obligations. At the other end of the chain, Germany was on that downhill political career which Chancellor Brüning unsuccessfully tried to arrest by voicing to the world the intense popular feeling that no more political impositions could be paid. France was fearful lest a prolongation of the moratorium on reparations might mean their final extinction, and lest she should be trapped into forgiving Germany reparations before she had any guarantee from the United States of an equivalent relief from war debts. The British public, though sympathetic towards the German case, and willing as in the past to wipe the slate of war debts and reparations completely clean, was tackling a grim budgetary task and was becoming convinced that in demanding her full pound of flesh the United States was wounding herself, preventing world economic revival, and committing a harsh moral injustice. It was not until June 1932 that a Reparations Conference could be summoned at Lausanne, 'to agree on a lasting settlement of the question raised in the report of the Basle experts'. Meanwhile an atmosphere more favourable to concessions to Germany had been created by the advent of a Radical Government under Monsieur Herriot to power in France.

After more than one all-but-fatal crisis, the Lausanne Conference reached an agreement on the 9th July. Reparations

were to be abolished; the Young Plan and the London terms for the postponed 'Hoover' annuities were alike abrogated. The German Government, however, would deliver to the Bank for International Settlements 5 per cent. redeemable bonds to the amount of Rm.3,000 million. The Bank would make public issues of these bonds as it might think fit, provided that no bonds should be negotiated for three years to come, that the issue price should not be lower than 90 per cent., and that all bonds not issued after fifteen years should be cancelled. The German Government also undertook to apply one-third of the net proceeds of any foreign loan which they might subsequently issue to the repurchase of these bonds. The proceeds of the bonds were to be placed to a special account pending future agreement between the creditor Governments as to its allocation. An agreement was also signed releasing Germany from the liability to make any payments pending the ratification of the main agreement, or pending notification by one of the six major Governments of its decision not to ratify. As to this, the four chief reparation creditors—Great Britain, France, Italy, and Belgium—signed a subsidiary pact declaring that they would not ratify the Lausanne agreement until a satisfactory agreement had been reached between them and their own creditors. If such an agreement were not forthcoming, the interested Governments would have to consult together again, and the legal position would revert to that which existed before the Hoover Moratorium. In a separate letter the British Government undertook not to exact war-debt payments from France and Italy until the same condition had been satisfied.

This arrangement among the reparation creditors, though obviously necessary in some form or other if they were not to find themselves grasping the muddy ends of both sticks—reparations and war debts—was strongly resented by American opinion, which regarded it as an attempt at moral blackmail against the United States. American capacity to act in a conciliatory spirit over war debts, already hamstrung by the prejudices of public opinion, was further fettered between November 1932 and the following March by the fact that there was in office a President already defeated at the polls and

confronting a hostile Congress. President-elect Roosevelt refused to commit himself before his installation. A British proposal that the war-debt instalments due on the 15th December should be postponed while discussions on the future of the whole problem proceeded was turned down by Washington. The American Government argued that Congress alone could authorize a suspension or reduction of debt payments, that there was no connexion between reparations and war debts, and that payment in December would greatly increase the prospects of an ultimate settlement. After a further exchange of Notes, which seemed to be directed as much to justifying the parties at the bar of world public opinion as to any prospect of mutual accommodation, the British Government paid the December amount in full. They unilaterally proposed, however, to treat this sum (about £30 millions) as a capital payment, of which account should be taken in any final settlement, and they paid in gold 'as being in the circumstances the least prejudicial of the methods open to them'. Monsieur Herriot was in favour of a similar conditional payment, but French opinion was exasperated by the unrelenting American attitude, and the Government, being roundly defeated in the Chamber, was obliged to resign.

When the date of payment actually arrived, it was found that Great Britain had paid in gold and that Czechoslovakia, Finland, Italy, and Lithuania had also paid, while Belgium, Estonia, France, Hungary, Poland, and Jugoslavia were in default. In regard to Austria, Greece, and Latvia, postponement had been arranged within the terms of their agreements, while no payment was due from Rumania until June 1933. Meanwhile Great Britain refrained for the time being from making any demands for payment from her debtors.

In January 1933 His Majesty's Government accepted an invitation proffered by Mr. Stimson, the American Secretary of State, 'to send a representative or representatives to Washington as soon as possible after the 4th March to discuss the American debt question', and to exchange views with the incoming President on other world economic problems. On the 25th April the following joint statement was issued by Mr. Roosevelt and Mr. Ramsay Macdonald:

'During the day the Prime Minister and the President have discussed the problems of the debt of the British Government to the United States Government. Both have faced the realities and the obligations, and both believe that as a result there is laid the basis of a clearer understanding of the situation affecting the two nations. It would be wholly misleading to intimate that any plan or any settlement is under way. It is the simple truth that, thus far, only preliminary explorations of many different routes have commenced. The point to be emphasized is that with the most friendly spirit progress is being made. After the Prime Minister's departure these conversations can well continue in London and Washington.'

Although Sir Frederick Leith-Ross stayed behind to discuss the war debts problem, the next move was an American notification that an instalment was due on the 15th June. In reply, the British Government cited reasons for concluding that

'payment of the June instalment could not be made at this juncture without gravely imperilling the success of the [World Economic] Conference and involving widespread political consequences of the most serious character. In their view the instalment should be considered and discussed as part of the general subject of War Debts, upon which they are anxious to resume conversations as soon as they can be arranged.'

The Government's principal argument was that the debts could not be separated from the complex of influences that had brought about the economic depression. The success of the Lausanne Conference, for instance, had initiated a general rise of commodity prices, whereas the disappointment of the prospects of a final war debt settlement, and the payment of the December instalment, had brought about a contrary movement, which was felt just as much in America as in Europe. In order that the main issue should not be prejudiced, the Government proposed to make an immediate payment of $10 millions, as an acknowledgement of the debt pending a final settlement.

To this proposal the United States Government returned a favourable reply. In view of the fact, wrote the President in an explanatory statement for the American public, that the

British Government's offer had been accompanied by a clear acknowledgement of the debt itself, he personally did not characterize the resultant situation as a default. Beyond this the law and the Constitution did not permit him to go; for Congress alone had the right to alter the amount and method of payment of the debt. Nevertheless, he could entertain representations on the subject by the British Government, and in response to their request he had suggested that such representations be made in Washington as soon as convenient.

The United States Government having intimated that in accordance with permissive legislation passed by Congress silver would be acceptable in payment of the 'token' instalment, at 50 cents an ounce, Great Britain duly delivered 20 million ounces of silver purchased at market price (about 1*s.* 8*d.*) from the Government of India. Czechoslovakia, Italy, Lithuania, and Rumania used a like method of making token payments. Latvia also paid a small sum, not in silver. Of all the debtors, Finland alone paid in full (in silver), France and the remainder defaulting entirely. The French Government, in making known their intention to defer payment of the June instalment, declared, however, that 'there was no thought of the unilateral breaking of engagements freely assumed'.

In October 1933 Sir Frederick Leith-Ross went with other experts to Washington to discuss the war debt problem once again, but although the conversations were prolonged for more than a month no agreement was reached. The reason for this failure was not merely the obstinacy of either party. The United States Government rightly pointed out that it was foolish to try to assess economic possibilities on the evidence of prevailing conditions, which no one expected to endure. Whereas, moreover, the United States Government naturally intended the debt to be fixed in dollars, the dollar was now unstable, and its value might later vary widely in terms of sterling or of gold, which would clearly alter the burden falling on the debtors.

When it became plain at last that the negotiations must prove abortive, the mission returned home and the British Ambassador at Washington addressed to the Secretary of State a note offering on behalf of His Majesty's Government

a further token payment in place of the instalment due on the 15th December. As the President no longer had power to accept silver at 50 cents an ounce, they proposed to make a payment of $\$7\frac{1}{2}$ millions in United States currency. Officially, the American Government simply took note of this proposal, but the President again expressed his own opinion that Great Britain should not be regarded as in default.

With the exception of Rumania, from whom no instalment was due, the same countries made token payments in December as had made them in June, and Finland again paid in full. This was the last occasion on which the token payment method was generally employed. Meanwhile, although the Lausanne agreement had never been ratified, the reparations era was at an end. Herr Hitler was already in full power, and neither political nor economic conditions made it possible for the creditors to consider asserting their claims.

(b) *Bilateral Trade Agreements*

In every year since the War, but especially after the restoration of Central European finances and the arrest of inflation, there was in Europe and elsewhere a large or small crop of bilateral trade treaties. The crisis years of 1931 and 1932 were not without their harvest, though trade treaties of the ordinary kind were outnumbered by the special clearing agreements made by countries who were subjecting foreign exchange transactions to Government control. The principle of such agreements was generally that exchange credits for the purpose of imports would be allotted by a joint clearing house in equal proportions to each of the two countries concerned, so that imports and exports between them would always just balance; but there were numerous variations from the type. These clearings tended to act rather as an additional hindrance to commerce than as a mitigation of existing obstacles.

France was generally regarded at this period as one of the chief exponents of economic nationalism, and certainly her emergency quota restrictions formed a new and severe restraint upon her trade with other countries. While world prices were falling sharply, French price indices, especially indices of the cost of living, showed a contrary tendency. This

naturally caused extreme difficulties among the producers of goods like cereals and other farm products which were peculiarly exposed to the world price-deflation; and measures were accordingly taken to protect them. This, however, only created a new disequilibrium, for it raised the cost of living still further; manufacturers, faced with acute price-cutting in foreign markets, found their costs actually rising and their employees clamouring for higher wages. The disequilibrium was tolerable so long as unemployment in France was negligible, and French industries, with the advantage of up-to-date plant and strong finances, were holding their own in world markets. By the beginning of 1932, however, neither of those conditions still held; exports had fallen disastrously, and unemployment was assuming threatening proportions.

Yet even France attempted to negotiate agreements for a truce in the universal tariff war. In August 1932 special agreements for the abatement of restrictions recently imposed on French goods were concluded, in return for equivalent concessions, with Belgium, Spain, and Italy; but the most important efforts of France towards a new tariff policy in 1932 were made in relation to Germany and the United States. In August 1932 the United States Ambassador in Paris presented an *aide-mémoire* requesting the modification of existing quotas, and especially protesting against features of the recent Franco-Belgian agreement which his Government regarded as constituting unfair discrimination. The negotiations, however, were baulked by a fundamental difference between French and American trade policies. The French tariff, consisting of a general tariff and a minimum tariff (the latter accorded only to countries which had granted French exports advantageous treatment), was designed for the conclusion of discriminatory trade treaties; whereas the United States tariff law made no provision for any rate of duty below the general rate, only for an increase in the case of countries discriminating against American goods. This difference prevented the negotiations between the two countries from achieving any success at that time.

In February 1932 the commercial relations sub-committee of the Franco-German Economic Commission, which was set

up under the terms of the trade treaty of 1927, negotiated a series of agreements for the more liberal operation of the quota system as between the two countries. This, however, was but the prelude to a general review of the 1927 treaty, which was begun in Berlin in November 1932. There were two main reasons prompting the French Government to make this move: first, in the absence of reparations the balance of trade in Germany's favour was considered excessive, and, secondly, the whole system of trade relations needed revision in the light of the abnormal barriers other than tariffs that had been erected. Both countries wished, further, to secure the maximum of tariff freedom in view of their forthcoming, or possible, negotiations with other countries. The new agreement made certain modifications of tariffs and quotas, and established an exchange-clearing arrangement, but its chief interest here lies in the modification effected in the most-favoured-nation clause. Most-favoured-nation treatment would be maintained in principle, along with fixed maximum charges on a number of tariff items, automatically accruing to other most-favoured nations. In future, however, either country might cancel any such fixed maximum charge at fourteen days' notice, and thus the signatories secured almost complete freedom in relation to each other or to other countries. In a statement on the agreement Monsieur Durand, the French Minister of Commerce, said that the most-favoured-nation clause would no longer hinder France in trade negotiations. Most-favoured-nation treatment would be granted only in individual cases and on a reciprocal basis. It was understood that the French Government had particularly in mind the application of discriminatory duties against countries with depreciated currencies.

Germany was engaged in other bilateral trade negotiations in the course of 1932, though not always with success. An attempt to end the long tariff war with Poland to the mutual advantage of the countries failed, as did negotiations with Sweden for the replacement of the trade treaty which was shortly due to expire; it was reported that feeling in the Scandinavian countries was extremely resentful at the progressively more rigorous restrictions placed on their products in the interests of German agriculture, and hence was reluctant

to accord most-favoured-nation treatment to Germany. The latter herself, in December 1932, declared her refusal further to accord most-favoured-nation treatment to Argentina in spite of the existence of a long-standing treaty between them, on the ground that Argentina had granted a number of tariff reductions to Chile, which she extended to Great Britain and other countries possessing most-favoured-nation treaties with her, but not to Germany, and that this was the deliberate policy of the Argentine Government. Attempts to reach a new trade basis with Great Britain did not achieve success until April 1933, when a temporary arrangement providing for reciprocal concessions on specific items was initialed. In January 1932 the Reich Government had promulgated a decree authorizing the imposition of additional duties on goods coming from countries with whom Germany had no most-favoured-nation treaty. Among the countries in this category was Canada, with whom, at the end of the following December, a temporary agreement was signed, providing for mutual most-favoured-nation treatment for an initial period of three months. Canada would grant German goods the benefit of the intermediate tariff rates, while Germany would accord to Canada her conventional tariff, or the general tariff where no conventional rates existed.

This account of bilateral trade treaties in this period is, of course, only illustrative. But it is enough to show that there was wanting any real incentive or desire for a freer trade system, the individual countries being more concerned to defend their own economies by quotas and other restrictive means, and to negotiate agreements appropriate to this new régime.

(c) *The Stresa Conference*

One of the most pressing economic difficulties of the time was caused by the low prices and big supplies of cereals upon world markets. In execution of a resolution adopted by the Commission of Inquiry for European Union, a Conference of the grain-exporting countries of Central and Eastern Europe and of certain European importing countries was held on the 23rd February 1931, to 'make a common effort to find means

of disposing of the grain surplus' available in Europe. The Conference would not take upon itself to prescribe any practical solution, but at least the importing countries were persuaded to acknowledge the principle of preference for European wheat, maize, and barley. The Co-ordination Sub-committee of the Commission of Inquiry reported in September 1931 that the preferential arrangements contained in the German-Rumanian and German-Hungarian Commercial Agreements of the previous June and July conformed to the general conditions governing agrarian preferences that had been laid down by the Tariff Truce Conference of November 1930. These included the principle that such preferences must be a 'conditional, exceptional and limited' derogation from the most-favoured-nation clause.

A Conference of the four Great Powers concerned—Great Britain, France, Germany, and Italy—was held in London at the beginning of April 1932 to consider the economic reconstruction of the smaller countries of Central and Eastern Europe. Monsieur Tardieu then put forward the following plan. The five 'Danubian' states—Austria, Czechoslovakia, Hungary, Jugoslavia, and Rumania—should establish reciprocal preferences to the extent of one-tenth of existing tariffs. Certain other countries, including Germany and Italy, should grant the Danubian countries preferential entry for their agricultural products, without any direct compensation by way of counter-preferences. Lastly, a loan of $50 millions should be raised on the guarantee of the countries in whose centres it was issued, and spent, under international authority, for the protection of the budgets and the exchanges of the Danubian group.

This plan was rejected, and the London meeting proved altogether abortive, for a number of reasons. Neither Germany nor Great Britain viewed with favour a sacrifice of their most-favoured-nation rights without compensation. Germany, still smarting with the sting of having to abandon the scheme for economic *Anschluss* with Austria, disliked a proposal which would have brought the latter more closely into another economic orbit, that of Hungary and the Little Entente. The British Government had to refuse agreement to any plan involving financial contribution or guarantee.

Italy, also resenting in some measure the political implications of the plan, adhered to her preference for bilateral treaties. Nor were the Danubian countries themselves unanimous in their support for the plan. Austria in particular felt that too much favour was being shown to the agricultural as compared with the manufacturing countries in the group. In spite of this failure, further bilateral agreements for preferences on cereals were entered into, though their entry into force was sometimes delayed by the opposition of third states enjoying most-favoured-nation treatment.

The Stresa Conference was the result of the appointment by the Lausanne Reparations Conference of a special committee to propose:

'measures required for the restoration of the countries of Central and Eastern Europe, and, in particular:

(*a*) Measures to overcome the present transfer difficulties of those countries and to make possible the progressive suppression, subject to the necessary safeguards, of the existing systems of exchange control.

(*b*) Measures to revive the activity of trade, both among those countries themselves and between them and other states, and to overcome the difficulties caused to the agricultural countries of Central and Eastern Europe by the low price of cereals, it being understood that the rights of third countries remain reserved.'

The committee sat at Stresa from the 5th to the 20th September 1932 under the chairmanship of Monsieur Georges Bonnet. The following countries were represented by delegations: Austria, Belgium, the United Kingdom, Bulgaria, Czechoslovakia, France, Germany, Greece, Hungary, Italy, the Netherlands, Poland, Rumania, Switzerland, and Jugoslavia; while Latvia sent an observer.

The Stresa meeting was preceded by a Conference at Warsaw of the delegates of the eight agrarian countries of Central and Eastern Europe—Bulgaria, Estonia, Hungary, Latvia, Lithuania, Poland, Rumania, and Jugoslavia. Agreement was reached there on the following points of principle: (i) the progressive suppression of the obstacles to international trade; (ii) the assignment by the creditor states to the debtor states of import quotas sufficient to allow the latter to discharge their

debts; (iii) customs preference in favour of the agricultural products of the eight states; (iv) the raising of the prices of agricultural products by means of an improved organization of the consuming markets. This epitomized the policy eventually put forward by the agrarian states at Stresa.

Difficulties arose mainly on three scores, namely, the demand of industrial states like Czechoslovakia and Austria that their products should be no less favourably treated than those of their agricultural neighbours; the insistence of certain of the importing countries, notably Great Britain and Italy, upon the retention of most-favoured-nation rights; and the refusal of the British delegates to subscribe to any plan for an international stabilization fund. The French, Italian, and German delegations all laid schemes before the Conference. The French project, which was to take the form of a multilateral convention, included the grant of customs preference for cereals imported from the Danubian countries, and the establishment of a fund to which each importing state should contribute in proportion to the amount of its imports, with the aim of improving the market value of the cereals concerned. Italy, on the other hand, proposed a system of bilateral agreements for the purchase of grain from the Danubian countries. Each exporting country would receive, as a temporary measure, a subsidy proportionate to its average export of cereals in the past three years, to be provided by a toll levied upon every European country on the basis of its total foreign trade. In compensation, the grain-exporting countries would lower their customs tariffs. The German delegation agreed in principle to the French plan, but put forward an alternative in case the latter should be rejected.

Ultimately, the Economic and Agricultural Committee of the Conference drew up a report which was unanimously accepted by the Conference in plenary session. The United Kingdom delegation, however, drew attention to the special position of those countries, such as the United Kingdom, whose commercial policy did not include the imposition of quotas or heavy import duties on cereals; and they made reservations in regard to participation in financial contributions or guarantees. The Committee's report was based on a

draft multilateral convention, aimed at improving the price of cereals by a combination of the grant of preferences in bilateral treaties (subject to the rights of third states) and financial contributions to a special fund. The draft limited the preferences to be granted by the bilateral treaties or by collective action to the average quantities exported during the three years 1929–31. Signatory countries which were exporters of wheat, barley for fodder, maize, rye, barley for brewing, and oats, should 'receive facilities for their exports' within the specified limits. An aggregate sum of 75 million gold francs (£3,125,000 gold) should be taken annually from the proceeds of contributions by the adhering states towards a general fund for the economic and financial reconstruction of Central and Eastern Europe, and should be used to promote the revalorization of cereals. The share to be contributed by each state would be reduced in proportion to the effective operation of whatever advantages it had granted to selling countries. (Germany would acquit herself altogether of her contribution in this way.) In compensation for these favours the beneficiary countries undertook to grant adequate tariff concessions to the contributing countries by bilateral agreements, so far as compensation had not already been given. The advantages thus granted would in no case affect the rights derived by third countries from the most-favoured-nation clause, and would extend to all signatory states. The convention would not be binding upon any signatory until the various bilateral treaties had gone into force; it would expire on the 31st October 1935 unless world prices had previously reached a remunerative level.

When these proposals came before the Commission of Inquiry for European Union, at its session of the 1st October, under the chairmanship of Monsieur Herriot, their practical acceptance did not seem very probable. The British delegate once more expressed his Government's refusal to participate in financial guarantees, while opposition to the plan for the revalorization of cereals was also expressed by Monsieur Litvinov, for the Soviet Union, and by the representatives of most of the Northern European countries. The report of the Stresa Conference was then passed to the Council of the

League, with a request for expert examination; and a number of reservations were attached. For good or ill, the plan for the revalorization of cereal exports from Central and Eastern Europe remained bogged in the quicksand of committees and conferences.

The work of the Financial Committee of the Stresa Conference was of equal general interest and of equally little practical effect. The Conference was concerned with the affairs of eight countries,[1] whose financial and economic position differed widely. All of the group, except Greece, formally maintained the gold standard, keeping the 'official' rate of exchange up to the level of the gold parity; but, in fact, only Poland was managing to do so without the most rigorous control of transactions in foreign exchange. In Czechoslovakia foreign exchange dealings were regulated under licence, but not monopolized, by the National Bank; exchange was being granted for the service of short-term and long-term debts, and for their due repayment, without any restriction, except that debts owing to countries like Austria, Hungary, Jugoslavia, Bulgaria, Rumania, and Greece, which had established transfer restrictions of their own, were being paid not in foreign exchange, but by means of various kinds of clearings or blocked accounts. Greece was able somewhat to liberate conditions of release of foreign exchange upon her abandonment of the gold standard. In Hungary, dealings in foreign exchange were entrusted almost exclusively to the National Bank, and a moratorium on all debt transfers had been declared. Regulation of foreign exchange business came late in Rumania, but by the time of the Stresa Conference was almost complete. The full amount of foreign exchange was still being granted for the payment of interest on short-term debts and the service of long-term debts, and some releases were also effected for the repayment of short-term debt. Dealings in foreign exchange in Jugoslavia were likewise concentrated in the hands of the National Bank and of certain private banks specially authorized, although exporters were allowed to keep 20 per cent. of the proceeds of their exports.

[1] Austria, Bulgaria, Czechoslovakia, Greece, Hungary, Jugoslavia, Poland, Rumania.

The Bank was granting foreign exchange to the State to cover the whole of its requirements in respect of short-term and long-term debts, but to individuals only so far as it was able to do so after meeting Government requirements. The state and municipalities had been able to extend the date of maturity of certain short-term debts.[1]

That was the state of affairs which the Stresa Conference had to face. The whole problem, remarked the Financial Committee of the Conference, was dominated by two fundamental considerations. The first was the fall of prices, and the second was the fact that the economic structure of these countries had adapted itself to working, during the previous few years, under the continuous influx of foreign capital, an influx which had now ceased. The degree of indebtedness to foreign countries was in several cases excessively heavy, and the difficulties were enhanced by the fact that an unduly high proportion of the capital lent was in the form of short-term obligations.

> 'One definite conclusion [wrote the Committee] may be deduced from this situation: to add, before the necessary adaptation has been completed—as a result of new loans—additional charges to those over-heavy burdens which exist to-day, would be for those countries at the present juncture as little in the interests of the lenders as of the borrowers.'

The Committee added that the foregoing did not apply to the Austrian loan under the Lausanne Protocol.

The Committee went on to agree that it was difficult, in the circumstances, to avoid establishing a temporary system of restriction on foreign exchange dealings. Unfortunately, the result of the efforts of the several countries to remedy the disturbance of their external balance of payments had been not only nil, but actually negative. The final solution of the difficulty, therefore, could be found only in joint action on international lines.

Considering how exchange restrictions could be removed,

[1] The continued payment of full external public debt service having proved impossible, in January 1933 the Jugoslav Government successfully negotiated with their foreign bondholders for the establishment of a three years' moratorium on their dues both for interest and sinking fund, 25-year bonds being given in lieu of cash.

the Committee declared that there were two methods of securing greater freedom of trade in commodities: on the one hand, that of continuing deflation, until a new equilibrium was reached, based on the original gold value of the national currency; and, on the other hand, that of leaving the value of the currency to adjust itself to the new situation—while, of course, continuing with the greatest energy the efforts necessary to balance the different Budgets and the whole national economic system. In default of either of those two courses the policy of officially maintaining the gold standard, without the internal conditions which could give it reality, made the abolition of existing barriers impossible. A third method had sometimes been envisaged—that of replacing the actual legal parity of the currency by another. The Committee considered that this operation would be most hazardous in the circumstances, in the absence of effective outside support. Next, the Committee turned to measures involving outside co-operation. As far as debts were concerned, no single solution was possible, on account of the profound differences which existed between the several countries. It must not be forgotten, insisted the Committee, that they were in the heart of a crisis, so that the measures to be taken should have a temporary rather than a final character. This attitude, similar to that of the League Financial Committee, appeared throughout the report. It was possible, wrote the Stresa Committee, that world trade was on the eve of revival. Discussing the problem of short-term debts the Committee observed that the existing Standstill Agreements presented evident drawbacks. In certain cases they had lumped together the sums falling due, further increased by arrears, and had fixed the same date of payment for all of them, thus intensifying the difficulty of a solution. In the interior of each country they had prevented the liquidation of intrinsically bad debts, and had thus stopped the painful but normal process of improvement and reduction. A transfer moratorium, whether official or *de facto*, had the same drawbacks, and others as well. The Committee recommended that funds belonging to foreigners should at least be available for capital employment within the country, and that arrangements should be made for their

progressive utilization for the purchase of exported goods. Foreign creditors must, as soon as possible, be able to choose their debtor within the country and enjoy all the advantages granted to national creditors.

The Committee then turned their attention to the problem of long-term debts. Most of these, and in some countries even all, were public debts; so that the issues turned partly on budgetary capacity and partly on foreign transfer capacity. The Committee emphasized the importance of the principle that in no circumstances could contractual obligations be modified unilaterally. Concessions made by foreign creditors should not result in placing them in a less favourable position than home creditors.

It might be hoped, wrote the Committee, that the various measures which they had recommended would safeguard the balance of payments of the countries concerned from a sudden attack at what had hitherto been its most vulnerable point. It would then be possible, by prompt and decided action, to abolish the system of restrictions on foreign exchange dealings. But when all that was done, and when the countries concerned had reached the threshold of a final adjustment in the relations of their economic life with that of the world at large, foreign assistance in currency matters might be found both necessary and expedient. Hence there had been put forward the idea of instituting a fund for the purpose of assisting at the opportune moment the 'normalization' or final regularization of currency conditions in Central and Eastern Europe.

The proposal for a currency normalization fund met with some opposition in the Committee, and was merely recommended for further consideration by the Commission of Inquiry for European Union, to which the Stresa Conference had to report. Nevertheless, it is important to note the details of the proposal, which bore a close resemblance to proposals put forward at a much later stage in world economic affairs by M. van Zeeland in his report of January 1938. (*a*) The immediate object of the fund would be to assist central banks by increasing their reserves at the opportune moment, thus facilitating the final abolition of exchange restrictions. (*b*) It would not be called into play until the last stage, when the

efforts of the interested parties were completed. (*c*) Nevertheless, a movement for promoting the idea of such measures should be launched without delay. (*d*) The fund would be constituted through an appeal to Governments, which would make the necessary sums available, either directly or indirectly. (*e*) It was desirable that as many countries as possible, especially the leading Powers, should contribute to the fund; the question of assessment of contributions was left open. (*f*) The working methods should be modelled on commercial practice; capital would be lent at interest and in accordance with the accepted rules for credit transactions. Subsidies paid into the fund would therefore have the character of loans, recoverable as soon as the fund had completed its task. (*g*) The administration of the fund should be entrusted to the Bank for International Settlements, though the measure of the Bank's independent power in respect of the fund was a matter of controversy.

These particulars were, generally speaking, confirmed by the Committee of Experts which was appointed by the Council of the League to examine the proposal for a currency normalization fund. The committee, which met in November 1932, did not consider it possible to undertake at that time the detailed and thorough preparation of the scheme, but was content to elaborate certain points, and in these doldrums the matter rested.

(d) *Other Multilateral Action: The Oslo Group: The Belgo-Dutch Convention*

For the failure both of bilateral treaties, based on the most-favoured-nation clause, and of multilateral efforts like the Stresa Conference to achieve in this period any appreciable general reduction of tariffs, a number of reasons can be adduced. First of all came all those obstacles inherent in the nature of protective tariff systems—the vested interests sheltering behind them and the difficulty of exchanging the advantage of one industry, manufacturing principally for the home market, for that of another industry seeking larger markets abroad. Then there were political reasons—the widespread fear of war or blockade, which rendered the

countries of the world unwilling to sacrifice economic independence, however dearly bought; and the particular antagonisms between different countries or groups, of countries which hindered the conclusion of commercial treaties among them. Possibly, too, as the sub-committee of economic experts mentioned below suggested, another reason was the want of any clear conception of the ultimate goal. 'In the absence of such a conception to act as a guide as well as an encouragement, tariff reduction, whether by general agreement or by means of bilateral treaties, appeared in the light of a bargaining arrangement and not of a step towards a new and better system of international economic life.' As far as Europe was concerned—and that was the limit of its terms of reference—the sub-committee declared that 'the ultimate goal must be the widest possible collaboration of the nations of Europe in the sense of making Europe a single market for the products of any and every country in it'. Finally, countries were reluctant to enter into arrangements one with another for the mutual reduction of tariffs, knowing that the advantage of any such reduction would also be enjoyed by third parties who had granted no counter-concession, by virtue merely of their possessing most-favoured-nation rights. Thus, while the general application of the most-favoured-nation clause acted as a brake on the upward movement of tariffs and checked tendencies towards catastrophic tariff wars, it certainly was a hindrance to the conclusion of limited arrangements for the reduction of tariffs among groups having some politico-geographical and economic unity—a risky procedure in normal times, but one which offered some hope in days of ever-growing restrictions on international trade during the world depression.

This question was the one that most exercised the sub-committee of economic experts, appointed in accordance with a resolution of the 28th May 1931 of the Commission of Inquiry for European Union, 'to examine in complete freedom and in a spirit of liberal understanding all means which might seem calculated to bring about closer and more profitable co-operation between the different countries with a view to improving the organization of production and trade.' The

sub-committee held two series of meetings under the chairmanship of Dr. Trip (Netherlands), and signed its report on the 29th August 1931. The experts affirmed that they did not wish in any way to modify 'the general basis of the most-favoured-nation clause, which must remain the essential safeguard of normal commercial relations between the nations'. They thought, however, that cases might arise in which countries which were not parties to the agreements in question might be willing to agree to some modification of their rights in view of the benefits likely to accrue to the world in general from the growing prosperity of Europe as a whole which such agreements were designed to promote.

From the economic point of view, they agreed, the *rapprochements* which they envisaged should be subject to the following conditions:

(*a*) The groups of countries which they affected should be such as to ensure that they were in conformity with the general interest and contribute to the general progress of Europe. (This was really a reservation intended to rule out disturbing semi-political accords. The sub-committee was working under the shadow of the Austro-German customs union dispute, which affected the attitude of several of the delegations.)

(*b*) They must not injure the interest of other countries, but must, on the contrary, tend to encourage economic intercourse with them.

(*c*) They must as far as possible include the free movement of individuals, goods, and capital, and indeed all forms of economic activity.

(*d*) If they were to lead to treaties or agreements different from the ordinary commercial treaties:

(1) These must be open to accession by all countries prepared to conform with the obligations which such treaties or agreements entailed.

(2) They must provide for the granting of the stipulated advantages to non-signatory countries which should accord equivalent advantages, whether by treaty or by virtue of their own autonomous policy.

The sub-committee added that the peril implicit in the diversion of trade through the conclusion of any economic

agreements could be avoided only if they were such as to initiate a movement for the reduction of tariff barriers generally.

If, said the economic experts, the understandings envisaged were to take the form of customs unions, then they would achieve the desired results only if they took into account the situation of countries not prepared to participate. Among the latter (to paraphrase the report) would be countries whose tariffs were too high and those whose tariffs were too low; the former being unwilling to abolish their tariffs on the products of the participating countries, and the latter being unwilling to raise their tariffs against the rest of the world to the level established by such a customs union. As for the first group, progress must be sought either by an extension and improvement of the actual system of commercial treaties, or by the conclusion of general agreements for preventing the increase of trade barriers, such as the abortive Tariff Truce. As regards the the second group (the sub-committee plainly having its eye on Great Britain, where a few days previously the first National Government had been formed, and a 'revenue tariff' seemed a probable contingency), it was wrong that they should be denied the chance of participating in agreements for the abolition of mutual tariffs in Europe, or that the price of their participation should have to be the increase of their tariffs to the level of the other participants. Their present liberal policy might 'serve as a basis upon which greater freedom for international commerce throughout the world as a whole could be built'—perhaps a desperate prayer to the British Government. It was therefore desirable that any European group or nation which was willing to extend the freedom of its market by the inclusion of free-trade or low-tariff countries should be permitted to do so, subject to agreement in regard to duties intended for the production of revenue.

The experts went on to consider the place of international industrial agreements (cartels) in the furtherance of trade, and elaborated their advantages and their dangers, which it was the duty of individual states to obviate. Some of the delegates expressed the view that agreements among producers might one day come to transcend and obviate tariff barriers generally. It may be noted here that the policy of direct industrial

co-operation (rationalization, or complementary production) was powerfully advocated by British industrial interests before the Ottawa Conference, as the best means of enlarging and improving trade within the British Commonwealth, and that an understanding between the iron and steel producers of the United Kingdom and Canada—the 'Montreal Pact'—was the basis of the iron and steel sections of the new Canadian tariff schedule as incorporated in the Ottawa Agreement.

These considered and unanimous opinions of a group of economists, bankers, business men and others representing the countries of Europe were not in every case precisely in accord with those of their respective Governments. The British Government, in their published commentary on the report, declared that they had always held that customs unions proper must necessarily constitute an exception from the most-favoured-nation clause, but that as for economic *rapprochements* not amounting to complete customs unions, such as regional tariff preferences, they remained of the view that it would cause conflict with the whole spirit of the most-favoured-nation clause if it were open to any countries to conclude arrangements with each other which they did not extend to other countries. This difference of opinion was the cause of the resignation of Sir Walter Layton from the preparatory committee for the World Economic Conference, in October 1932; for Sir Walter, who had been the British delegate to the meeting of economic experts, found himself too much at variance with the Government's conservative attitude towards the most-favoured-nation clause to continue as his country's representative on the preparatory committee.

The British Government had had occasion, meanwhile, to give practical expression to their attitude in this matter. The possibility of an understanding among the low-tariff countries of Northern Europe for mutual reductions of tariffs had been exposed by the conclusion of the Oslo Convention of December 1930 (entering into force on the 7th February 1932), by Norway, Sweden, Denmark, Holland, Belgium, and Luxembourg (who was in customs union with Belgium). Each of the signatories undertook for one year not to raise its tariffs on the goods of the other parties without first notifying

them and giving them an opportunity to negotiate an equitable compromise. In a separate protocol the signatories expressed their readiness to enter into further negotiations and their intention of supporting any international efforts which might be made in the future for the reduction of tariffs. They all later ratified the Tariff Truce Convention of the 24th March 1930. It was generally recognized, however, that the strained financial conditions of 1931 and 1932 greatly handicapped further progress in this direction. It was something of a surprise to the outside world, therefore, when it was announced, on the 20th June 1932, in the course of the Lausanne Conference on Reparations, that the Governments of Belgium, Luxembourg, and the Netherlands had initialed a Convention for the progressive reduction of the tariffs on each other's goods by 10 per cent. of their amount per annum. The conversations which led up to the signature of this agreement had included the other participants in the Oslo Convention, but the Scandinavian countries, all of whom had suffered exchange depreciation since Great Britain's relinquishment of the gold standard, preferred to postpone any action until economic conditions were more settled—perhaps until they had investigated the possibilities of a tariff understanding with Great Britain. In a covering statement the Belgian delegation to the Lausanne Conference stated that the Convention was based upon principles formulated on various occasions by the League of Nations—presumably those embodied in the report of the economic experts' committee quoted above. In particular, while the advantages accorded by the Convention were reserved to the states taking part in it, any other state might adhere to it on a footing of equality with the three signatories. The announcement was accompanied by the publication of a vigorously worded appeal by the King of the Belgians for the reduction of barriers to trade throughout the world.

The text of the Convention of Ouchy-Lausanne was not published until the 3rd August. According to Article 1 the contracting parties pledged themselves not to increase customs duties existing between them above their actual level, nor to establish duties not already existing. They further agreed not to proceed to any protective increase of their

customs duties, nor to any establishment of new protective duties applying to the merchandise of third states to whom they were bound by commercial conventions, unless those states, by a further raising of customs barriers or obstacles to trade, should cause serious prejudice to the signatories. Article II provided for the progressive reduction of customs duties, in the signatories' reciprocal relations, by 10 per cent. of their existing rate per annum, beginning with an immediate cut of 10 per cent. and ending four years later, by which time the duties would be one-half their former rates. Duties would in no case be reduced below a rate corresponding to 4 per cent. *ad valorem* for semi-manufactured products and 8 per cent. *ad valorem* for entirely manufactured products. While reserving the right to make certain exceptions, the contracting parties undertook in Article III not to apply between them any new prohibition or restriction on import or export, or any new measure of regulation which would have the effect of hampering their reciprocal exchanges. But should those exchanges be seriously disturbed by abnormal circumstances, each of the parties would have the right to limit its exports or imports, provided the quota fixed should not be less than 100 per cent. of the average quantities exported or imported during normal years. Further, the contracting parties agreed to abolish, as soon as circumstances should permit, in their reciprocal relations, all existing measures of prohibition, restriction, or regulation, with specified exceptions. By Article V they undertook to apply to their reciprocal exchanges the unconditional and unlimited most-favoured-nation clause. The Convention was concluded for a period of five years (Article VII); thereafter it would remain in force, for those who had not denounced it, from year to year. Article VIII laid down that any third state would have the right to adhere to the Convention, on a footing of equality with the signatory states, and moreover that so long as third states, without adhering to the Convention, nevertheless observed its provisions in fact, they would be admitted to the benefit of the conventional régime.

Not merely was the Convention favourably received by public opinion in the participating countries; it was followed by an agitation for the establishment of a complete customs

union among them. A referendum on the subject was held by the Netherlands Chamber of Commerce in Belgium, and, out of nearly 1,100 replies received from Chambers of Commerce and other representative institutions, industrialists, merchants, and bankers in Belgium and Holland, no less than 87 per cent. were favourable to a tariff union.

The official attitude of the British Government towards the Convention was that their own policy in respect of their commercial treaty relations with foreign countries must await the outcome of the Ottawa Conference, but that meanwhile they must insist on the preservation of their most-favoured-nation rights unimpaired. After the Ottawa Conference they proceeded to enter into negotiations for trade treaties with a number of countries, chiefly the Scandinavian group and Argentina, with which the commercial relations of the United Kingdom were close; but the new agreements were in traditional form and of limited scope. The use of the quota system to regulate British imports of certain foodstuffs enabled the British Government to grant exclusive concessions to a few countries without violating most-favoured-nation treaties, at any rate according to a strict interpretation of their terms. In effect, the attitude of the British Government rendered the Convention of Ouchy-Lausanne abortive.

(e) *The Ottawa Conference, 1932*

It does not beg any questions about the value of the Ottawa Conference in promoting or deferring world trade recovery to include the Conference among the efforts to escape from the toils of ever-rising tariffs. Undoubtedly in the popular mind, and explicitly in the mind of the Government, one of the chief reasons for the imposition of the British tariff was the need for a weapon with which to secure more liberal treatment abroad for Great Britain's exports; and what more favourable field for the exercise of such persuasion could there be than the British Commonwealth, in which pleas of commercial advantage could be reinforced with appeals to imperial sentiment? Imperialists of the narrower school demanded, in effect, preference for preference' sake, but by reason both of her political history in tariff matters, and of her obvious eco-

nomic interest, Great Britain sought at Ottawa an extension of preference from the Dominions essentially by means of a reduction of the latter's tariffs against British goods, rather than an enhancement of their tariffs against foreign goods.

This point of view was emphatically expressed by Mr. Baldwin, who led the United Kingdom delegation, both in his opening speech to the Conference and in a supplementary statement which was issued after Mr. S. M. Bruce had declared that the Australian people regarded the British preferences granted under the Import Duties Act 'as a somewhat tardy response for the benefits from Australia long enjoyed by British industry'.

'What then [asked Mr. Baldwin] should be the first aim of this Conference? It should be to clear out the channels of trade among ourselves. . . . There are two ways in which increased preference can be given—either by lowering barriers among ourselves or by raising them against others. The choice between these two must be governed largely by local considerations, but subject to that, it seems to us that we should endeavour to follow the first rather than the second course. For however great our resources, we cannot isolate ourselves from the world.'

'It is [he said in his supplementary statement] necessary to bear in mind that the percentage of duty charged on the value of the article is of great importance in assessing the value of a preference. A preferential rate of duty, if the preference is to be of material assistance, must not be so high as, in effect, seriously to restrict importation: and the United Kingdom delegation would urge upon the Dominions that the rates of duty charged should be so graduated as to give the products of the United Kingdom a reasonable chance of competing on equal terms, and that the rate of duty against United Kingdom products should be fixed for protective purposes no higher than is necessary to give a reasonably efficient industry in the Dominion a fair chance. In this connexion they desire to draw attention to the favourable tariff treatment which they have hitherto accorded to imports from the Dominions which compete with goods produced in the United Kingdom.'

Indeed, in its sole general statement of principle the entire Ottawa Conference recorded its conviction:

'That by the lowering or removal of barriers among themselves provided for in [the] Agreements the flow of trade between the

various countries of the Empire will be facilitated, and that by the consequent increase of the purchasing power of their peoples the trade of the world will also be stimulated and increased.'

How far was this claim justified? The agreements between the United Kingdom and the Dominions were to run for at least five years; that with India was made terminable on six months' notice by either party. It may be noted that in the field of international commercial agreements five years is an exceptionally long term of currency without the possibility of denunciation. Great Britain undertook (*a*) to continue free entry for all Empire products already admitted free, (*b*) to impose fresh duties (i.e. to clap on duties where none existed, or to increase actual duties, or to consolidate *ad valorem* into specific duties) on certain imports from foreign countries, notably wheat, maize, butter and cheese, canned and dried fruits, a number of raw fruits, copper, lead, zinc, linseed and rice;[1] (*c*) to regulate quantitatively imports of chilled and frozen beef and frozen mutton and lamb and (when the Commission on the reorganization of the pig industry should have reported) bacon and ham, with the aim of raising the wholesale price of meat in the British market to such a level as would maintain efficient production at home and in the Dominions, and of giving the latter an expanding share of British imports of meat; (*d*) to maintain certain existing preferences, i.e. by not reducing the existing duties on foreign imports of the commodities concerned; and (*e*) to perform certain other undertakings, chiefly regarding the consolidation of preferences on tobacco, South African wine and coffee, but including also an undertaking given to Canada that if the preferences granted or guaranteed at Ottawa appeared likely to be frustrated in whole or in part through state action on the part of any foreign country, the United Kingdom Government would exercise their powers to prohibit the import of such commodities from the country in question for so long as was necessary to make the preferences effective. In pursuance of this undertaking,

[1] The imposition of duties on foreign wheat, copper, zinc, and lead was made conditional upon the ability and willingness of Empire producers to supply all United Kingdom requirements of these commodities at prices not exceeding world prices.

the British Government on the 17th October gave six months' notice of denunciation of the 1930 commercial agreement with the U.S.S.R., which granted the latter most-favoured-nation rights.[1] The incidence of the new duties imposed on foreign imports under the Ottawa Agreements is shown, first, by the fact that the proportion of imports from foreign countries admitted free, which was 83 per cent. before the various tariff measures were passed by the National Government, fell as a result of the Ottawa Conference from 30 per cent. to 25 per cent.; and, secondly, by the following table prepared by the *Economist*:[2]

Protective duties before Ottawa			*Protective duties after Ottawa*		
Percentage of foreign imports taxed at			Percentage of foreign imports taxed at		
10%	11–20%	Over 20%	10%	11–20%	Over 20%
32·9	15·3	4·6	28·3	21·8	7·7

The countries on whom the new duties fell particularly onerously were Denmark, Holland, Belgium, Sweden, Italy, Finland, Poland, and Chile, while Argentina stood to lose most trade through the regulation of meat imports.

Among the concessions granted by the Dominions and India in exchange for these favours, mention must first be made of the common undertaking entered into by Canada, Australia, and New Zealand. They promised, first, to give tariff protection only to those industries which were reasonably assured of sound opportunities of success, and, secondly, to keep or reduce protective duties to a level which would give United Kingdom producers full opportunity of reasonable competition on the basis of the relative costs of economical and efficient production, provided that special consideration might be given to the case of industries not fully established.

[1] In April 1933, during the course of the trial of a number of British subjects on charges of counter-revolutionary activities in Russia, the British Government imposed an embargo on imports of the following commodities from the Soviet Union: butter, wheat, barley, oats, maize, poultry and game, raw cotton, petroleum, and timber. The embargo was removed on the 1st July 1933, on the release of the two British subjects who had been imprisoned as a result of the trial. The counter-embargo which had been imposed by the Soviet Government was withdrawn simultaneously, and negotiations for the conclusion of a fresh commercial treaty between the two countries were thereupon resumed.

[2] *Ottawa Supplement*, 22 Oct. 1932, p. 7.

In Canada and Australia these conditions would form the terms of reference to independent tariff boards, before whom British producers should henceforward have the right of stating their case, while in New Zealand the agreement would be implemented by the Government directly, British producers again being given a hearing. The above principle of the 'compensatory tariff', which incidentally was the theoretical basis of the United States tariff schedule, was regarded by some as the most important feature of the Ottawa Agreements and as the one most calculated to secure a liberation of trade by reducing Dominion tariffs, despite the obvious fact that if it were rigorously carried out it would consume the mutual advantage of international trade altogether, rendering the latter redundant and impossible except in cases of dumping.[1] The further principle, that exporters should be heard before a revision of a tariff was carried out, was also of considerable general importance in connexion with international trade relations.

All that can be related here concerning the specific changes in Dominion tariffs is the measure in which they involved a raising of tariffs against foreign countries. Australia undertook to apply a general formula for the guarantee of minimum British preferential margins, rising to 20 per cent. *ad valorem* preference where the duty on United Kingdom goods was over 29 per cent. *ad valorem*; the application of this formula commonly resulted in an increase of the general tariff. The Lyons Government was in any case pledged to the removal of the prohibitions and the grosser features of high protectionism that characterized the Scullin tariff. On 132 items in the Canadian schedule, which covered 215 items in all, there would be a reduction of the duties on United Kingdom goods (accompanied in some instances by a simultaneous raising of the foreign duty), while in respect of the remainder increased margins of preference were to be secured for the United Kingdom by means of advances of the general tariff.

It was estimated, on the basis of 1931-2 imports into Canada, that the British preferential tariff would be reduced to zero in categories of which total imports were $31,200,000, including

[1] See below, pp. 298-303.

\$8,300,000 of British goods; that the preferential tariff would be otherwise lowered in categories of which total imports were \$58,900,000, including \$37,400,000 British; and that the foreign tariff would be raised in the case of \$35,100,000 of total imports, including \$8,800,000 British. The total trade affected by the schedules was thus \$70,700,000 of foreign goods and \$54,500,000 of United Kingdom goods in 1931–2, representing roughly 22 per cent. of Canada's total imports.

The specific changes in the New Zealand tariff related only to four items, confectionery, clothing, hosiery, and silk and rayon piece goods, on all of which the British preferential duty would be reduced. South Africa undertook (*a*) to grant new or increased preferences on a brief list of manufactures, in most cases partially or wholly by means of an increase of the general tariff, (*b*) to impose new duties on certain foreign piece goods of cotton and rayon, and underclothing, leaving the existing British preferential tariff unchanged, and (*c*) not to lower existing margins of preference on a long list of British manufactures. Newfoundland, whose tariff was primarily revenue-producing and not protective, promised a preference of 10 per cent. on 61 classes of goods, with the qualification that the preference might be reduced if it resulted in a loss of revenue. The Indian Government undertook to give a 7½ per cent. preference on motor-cars, omnibuses, and accumulators, and to give a 10 per cent. preference on a long list of manufactured goods, to be secured either by an increase of duty on foreign goods or by a reduction of duty on British goods, or by a combination of both. It was estimated that in 1930–1 the volume of imports in the categories affected by this undertaking amounted to £32 millions, of which £12,700,000 were already imported from Great Britain. Southern Rhodesia promised increased margins of preference on electrical and radio material, typewriters, cutlery and glassware (in some cases inevitably by dint of an increase of the foreign tariff), as well as minimum specific duties on foreign cotton, silk, and rayon piece goods.

Perhaps the most satisfactory feature of the Dominions' concessions, from the point of view of liberation of trade, was the undertakings in respect of surcharges and other abnormal

hindrances to British trade. Australia promised to repeal as soon as possible the proclamation of May 1932 prohibiting certain imports, to remove as soon as practicable the surcharges imposed at that time, and to reduce or remove the primage duty as soon as the finances of the Commonwealth would allow. Canada promised to ensure a minimum of uncertainty, delay, and friction in connexion with tariffs, and to provide machinery for the prompt and impartial settlement of disputes; to abolish surcharges on United Kingdom imports as soon as possible and to consider the ultimate abolition of the exchange dumping duty on United Kingdom products. New Zealand undertook not to increase the existing primage duty of 3 per cent. on United Kingdom goods which were otherwise duty free, and to remove it as soon as financial conditions permitted.

Without attempting to compute the extent of each factor, we may observe that the Ottawa Agreements resulted in a certain measure of liberation of trade within the British Commonwealth, a certain measure of increase of British tariffs against the rest of the world (including an aggravation of the United Kingdom tariff), and some diversion of trade from outside to within the British Commonwealth. The effects of these phenomena on international trade and commercial relations generally cannot be accurately measured; but some comment may be made on the reaction of Ottawa upon Great Britain's potential ability to use her tariff to secure the reduction of foreign tariffs. That this use was, from the first, officially contemplated was shown by the terms of Clause 7 of the Import Duties Act, which provided for the reduction of duties, upon the recommendation of the Board of Trade, on the goods of any specified country. Now under the Ottawa Agreements the concessions that Great Britain could make for the benefit of foreign countries (except, of course, an undertaking not to increase existing duties) were limited for a period of at least five years in respect of all commodities for which the agreements provided a minimum general rate of duty or a minimum rate of preference where the preferential rate was already zero. This list of commodities included several, such as butter and timber, which were of particular interest to countries most

likely, on account of the closeness of their trading relations with Great Britain, to offer her advantageous reciprocal terms. Further, the Ottawa Agreements would certainly prevent the entry of Great Britain into a free-trade or very low tariff group, or any agreement like the Belgo-Dutch Convention for the progressive reduction of mutual tariffs to a low level. The admission of foreign countries to the whole preferential system enjoyed by members of the Commonwealth would be ruled out by a resolution of the Ottawa Conference affirming that while each Government would determine its particular attitude in its treaty relations towards other countries, the different delegations recorded their policy 'that no treaty obligations into which they might enter in the future should be allowed to interfere with any mutual preference which Governments of the Commonwealth might decide to accord to each other, and that they would free themselves from existing treaties, if any, which might so interfere'. In accordance with this resolution the South African trade treaty with Germany, which promised the latter the benefit of any preferences that might be subsequently granted to Great Britain, was abrogated at the instance of the South African Government.

Finally, the Conference deliberated the policy to be adopted by nations of the British Commonwealth towards the most-favoured-nation clause in commercial treaties, and decided that whereas each participant would still act independently in its relations with foreign countries, and on its own judgement, their unanimous policy was that the most-favoured-nation rights must be strictly upheld, against the tendency to modify them in respect of limited preferential groups, but that no claim could be countenanced to participate in the mutual preferences within the British Commonwealth, on the part of a foreign country pleading its most-favoured-nation rights.

VI

THE WORLD ECONOMIC CONFERENCE, 1933

THE Lausanne Conference of 1932 had been summoned to discuss not only reparations but also 'the other economic and financial difficulties which are responsible for, and may prolong, the present world crisis'. Besides appointing the Stresa Committee, the Conference appended to its Final Act an Annex embodying a decision to invite the League of Nations to convoke a World Conference on monetary and economic problems. In the meantime, the Annex recommended an examination of these problems by a committee of experts, to consist of two representatives of each of the six inviting Powers of the Conference (Belgium, France, Germany, Italy, Japan, and the United Kingdom), three financial and three economic members nominated by the League Council, two financial members appointed by the Bank for International Settlements, and representatives of the United States, should that country accept the invitation to participate.

Sir John Simon's motion at the meeting of the League Council on the 15th July 1932, embodying this resolution, evoked strong criticism from representatives of the smaller Powers; they felt that the Great Powers represented at Lausanne had foisted upon the League the terms of reference, and the machinery of organization, of a conference for which the League was otherwise to accept responsibility. Sir John Simon, however, pacified the critics, asking for the appointment of a committee of the Council to undertake the preliminary work, such as the determination of the place and date. Thus the World Economic Conference became a League affair.

As early as the 31st May 1932 the State Department at Washington had issued a statement referring to inquiries by the British Ambassador as to whether the United States would be willing to take part in 'an international conference for the purpose of considering methods to stabilize world commodity prices'. The Administration had replied that it felt that an early convocation of such a conference might be of real value.

The manner, however, in which the proposal for a World Economic Conference emerged from the Reparations Conference, suggesting that one of the primary subjects for discussion would be inter-governmental war debts, caused considerable anxiety and embarrassment to the United States Government.

At the end of July 1932 it was stated in Washington that the United States Government agreed to participate in the Conference only upon the condition that neither war debts nor tariffs would be discussed. The November elections put a rather different face on the terms of America's participation. President Roosevelt swept the country, at the head of a great Democratic majority, on a platform which included the negotiation of reciprocity treaties for the reduction of tariffs, and which generally had a lower-tariff bias. The war-debts problem had been passed over with a formula, and it continued to be barred from the agenda of the prospective conference, but the exclusion of tariff problems was interpreted as barring only the discussion of specific tariff rates, as distinct from general customs policy.

Meanwhile the technical preparations were going forward. The preparatory commission of experts met early in November and again at the beginning of January, under the presidency of Dr. Trip, the President of the Netherlands Bank. Their Draft Annotated Agenda, submitted to the League Organizing Committee on the 20th January 1933 was not a very decisive document. The object of the Conference, wrote the experts, as far as tariff policy was concerned, must be to reach a general agreement for the reduction of tariffs, and to maintain more moderate tariff policy in the future. As a preliminary measure, they suggested the conclusion of a 'customs truce'. To bring about a general reduction of tariffs, they went on, two ways were open—reduction by percentages, and reduction to a uniform level. The Conference should 'consider combining these two methods'. Without multilateral agreements in some form, the experts felt, no serious progress towards generally lower tariffs could be expected from bilateral negotiations.

They devoted a special section to the most-favoured-nation

clause, which, they considered, should under normal conditions form the basis of commercial relations between nations. They referred, however, to 'a suggestion which had been strongly pressed in various quarters', to the effect that 'states should admit an exception to the most-favoured-nation clause whereby advantages derived from plurilateral agreements should be limited to the contracting states and to such states as might grant equivalent advantages'. The Commissioners, who were plainly not of one mind on this issue, drew attention to the terms under which alone such exceptions to most-favoured-nation clauses could be admitted,[1] and concluded with the hopeful if unprecise recommendation that the Conference should endeavour to find a solution which would reconcile the interests of all.

This part, at least, of the experts' report presented comprehensive agenda but equally eclectic annotation. In other parts they were able to pronounce a more decisive judgement. Their recommendations on monetary questions are of particular interest in view of what happened when the Conference met. It must be remembered, however, that, when the Commission reported, the United States had not yet left the gold standard, nor was there then any apparent prospect of her doing so.

> 'The restoration of a satisfactory international monetary standard [they wrote] is clearly of primary importance. The World Conference, in the absence of another international standard likely to be universally acceptable, will have to consider how the conditions for a successful restoration of a free gold standard could be fulfilled.'

Among the conditions necessary for the restoration of a free international gold standard the Commission mentioned the restoration of equilibrium between prices and costs; the achievement of reasonable stability of world prices; the solution of major political problems; a settlement of intergovernmental debts; a return to a reasonable degree of freedom in the movements of goods and services, in the foreign exchange markets and in the movement of capital; a general understanding to ensure a better working of the gold standard

[1] See above, p. 150.

in the future; internal equilibrium in the different countries, including a balanced budget, healthy conditions in the money market and 'a sufficient degree of flexibility in the national economy'.

The experts admitted that countries off the gold standard found it difficult to return while the future of gold prices was uncertain. On the other hand, the very fact that exchanges continued to fluctuate helped to depress prices. In face of this dilemma they considered how to bring about such a general recovery as would facilitate a return to gold. Countries with a free gold standard and with abundant monetary reserves should pursue a liberal credit policy, should allow gold to flow out freely, and should not hinder sound foreign investments. Countries off the gold standard should not depreciate the external value of their currency below the point required to re-establish internal equilibrium, and should smooth out day-to-day fluctuations in the exchanges due to speculative influences. Wherever exchange restrictions had been introduced, they should be abolished as early as possible, beginning with restrictions applied to foreign trade.

It was important, the experts said, that any declarations in favour of the restoration of an international gold standard should, at the same time, indicate certain essential principles for its proper functioning under modern conditions. Central banks should be independent of political influence. Gold reserves, declared the Commission, were primarily required to meet external deficits. Yet legislation in many countries rendered much gold unavailable for international use. Among other possible remedies a great advance would be made if legal minimum requirements of gold were substantially lowered below the customary $33\frac{1}{3}$ or 40 per cent. ratio. The gold exchange standard, if properly controlled, might hasten the return to an international standard. Other methods of economizing gold included the replacement of small notes by subsidiary coin, and the increased use of cheques, especially in official transactions. Co-operation among central banks ought to be extended, especially through the Bank for International Settlements. While bimetallism must be regarded as impracticable, the Conference should examine how far the use

of silver in subsidiary coinage could be enlarged; also whether, and if so by what methods, the marketing of the metal was susceptible of improvement.

The next chapter in the report dealt with the disequilibrium between prices and costs. Obviously one method of restoring the lost balance was to reduce costs, but maladjustments between different sets of prices would not thereby be corrected; moreover, the burden of debts would continue to present difficult problems. Equilibrium might also be restored by a rise of prices, and one method of achieving that was to limit supply. On this point the references of the Commission were extremely guarded. Prices might also be raised by the pursuit of a liberal credit policy and by a reduction of long-term interest rates; but, if these measures were to have the desired effect, a demand for credit must arise, and that depended on increased confidence in the general financial and economic structure. The experts thought it improbable that public works could be internationally financed in the immediate future to any considerable extent. A recovery of sound international lending would have a helpful effect on prices. Obstacles to such a resumption must be cleared away; apart from exchange instability, they included the control of foreign exchange markets and, in certain cases, the existing burden of debts.

The members of the Commission were thus agreed at least upon the objectives: lower tariffs; the abolition of prohibitions, quotas, exchange controls, and other non-tariff restrictions on international trade; the stabilization of exchanges; the reform of the gold standard; higher prices; the resumption of international lending, if necessary after agreed adjustment of existing debts to meet altered circumstances. They were not wholly agreed upon the paths of international co-operation whereby these aims were to be reached. Nor did they present a programme indicating the order in which they thought the different problems should be tackled. Indeed, their general view was that only by dealing with the whole complex simultaneously could any real advance be achieved. The most definite recommendation on the issue of priorities was that in favour of the progressive relaxation, and complete abrogation

at the earliest possible date, of the emergency measures imposed as a result of the crisis. Action in that direction had an intimate bearing, the experts declared, upon the stabilization of currencies.

The Organizing Committee of the Conference had agreed that three months would be required for the Governments to consider the experts' draft annotated agenda before the plenary session of the Conference could be held. It was recognized, further, that it would be of little use to make the final preparations for the Conference until the new President had assumed office in the United States.

Soon after his inauguration President Roosevelt discussed with the British Ambassador the possibility of a visit by the Prime Minister of the United Kingdom, and on the 6th April Mr. MacDonald received and immediately accepted an invitation to discuss 'preparations for the World Economic Conference and the need for making further progress towards disarmament'. On the following day invitations to send personal representatives to Washington were dispatched to France, Germany, and Italy, and to Argentina, Brazil, Chile, China, and Japan. Later Canada and Mexico were added to the list. In the course of a press announcement the Secretary of State, Mr. Cordell Hull, declared that the United States had been one of the leaders in the movement of economic nationalism, and that now, when as a result of that movement every nation found itself 'flat on its back economically', it was high time to recognize that American responsibility involved leadership in a movement in the opposite direction. In fact, the Washington conversations were looked upon by the world at large as the first step away from the traditional isolationism of the United States.

On the 19th April, while Mr. MacDonald was on the Atlantic, the United States specifically abandoned the gold standard. This move was portrayed in some quarters as a deliberate seizure by the President of a potential bargaining instrument for his conversations with European representatives. Even if there were no escaping the decision, said these critics, the President must be blamed for not waiting at least until he had learnt the minds of Mr. MacDonald and his other

distinguished visitors. Considerations of courtesy, however, might have been dangerous, even if they could have overborne the urgencies of the moment. If America was to be off gold by the time the World Economic Conference met, it was as well that she should go off before the Washington conversations began; for they would otherwise have proceeded on quite false hypotheses.

Mr. MacDonald landed on the 21st April and spent five days in Washington. Before parting, he and Mr. Roosevelt issued a joint statement which was promptly adopted by public opinion as an unofficial programme for the World Economic Conference. The conversations, it ran, had disclosed that the two Governments

'were looking with a like purpose and a close similarity of method at the main objectives of the Conference. The necessity for an increase in the general level of commodity prices was recognized as primary and fundamental. To this end simultaneous action needs to be taken both in the economic and in the monetary fields. . . . There should be constructive effort to moderate the network of restrictions of all sorts by which commerce is at present hampered, such as excessive tariffs, quotas, exchange restrictions, etc. The central banks should by concerted action provide adequate expansion of credit, and every means should be used to get the credit thus created into circulation. Enterprise must be stimulated by creating conditions favourable to business recovery, and Governments can contribute by the development of appropriate programmes of capital expenditure.

'The ultimate re-establishment of equilibrium in the international exchanges should also be contemplated. We must, when circumstances permit, re-establish an international monetary standard which will operate successfully without depressing prices and avoid a repetition of mistakes which have produced such disastrous results in the past.'

Meanwhile, Monsieur Herriot had also begun his conversations with the President. Their object and result, according to a joint statement of the 28th April, had been as complete an understanding as possible between the two countries in regard to their common problems.

Up to that time, the group of countries on the gold standard had been opposed to the early convocation of the

Conference, as they felt that the time was not yet ripe. But the depreciation of the dollar presented to their currencies such a threat—real or imagined—as could only be exorcised by international agreement; and their impression of the Washington conversations was that President Roosevelt had promised to take part at least in *de facto* stabilization. Accordingly, at its meeting on the 29th April, the Organizing Committee fixed the 12th June as the opening date of the Conference.

It was at this period of the preparations that the United States Government took the lead in proposing the signature of a 'tariff truce' for the period of the Conference. The proposal was promptly acceded to by Great Britain and a number of other Powers, and by the 12th June fourteen states had accepted the truce (some with reservations), whereby they agreed not to adopt, before that date or during the proceedings of the Conference, any new measures which might increase the difficulties adversely affecting international trade. Forty-seven states afterwards acceded to the truce, making a total of sixty-one states, representing nearly 90 per cent. of the trade of the World.

In the six weeks that followed the summoning of the Conference, however, the rulers and governors of the United States were compelled by the tide of American affairs and opinion to project the economic policy of the nation inward rather than outward. Such measures as the National Industrial Recovery Act and the 'Farm-Inflation' Bill were calculated to force up the costs of industry and trade, and thus postpone once more the reduction of tariffs or the stabilization of currencies. Comfort was taken, however, from the terms of a message addressed on the 16th May by President Roosevelt to the heads of the states taking part in the Conference, in the course of which he mentioned as its objects 'the stabilization of currencies, the freeing of the flow of world trade, and international action to raise price levels'. But the inflationist and isolationist attitude of Congress could not be left out of account. Both before and during the Conference the American public was led to perceive a direct connexion between the day-to-day movements of the exchange rates and the fluctuations of commodity and stock markets. When the

dollar slumped, prices in Wall Street and the Chicago grain pit promptly moved up. When the dollar improved, the markets reacted. However delusive these circumstances may have been, they persuaded the public to regard attempts at securing the stabilization of the dollar as nefarious European plots to hinder American recovery. On the other hand, it became clear long before the Conference began that France, as the leader of the gold bloc, regarded exchange stability as the condition of advance in other directions.

In spite of these forebodings of failure, the Conference was launched with all the circumstance of great expectation. Representatives of sixty-four states met under the presidency of Mr. Ramsay MacDonald in the Geological Museum at South Kensington. King George V in person welcomed the delegates at the inaugural session, and his words formed an inspiring text for the greatest international assembly ever held.

'In the face of a crisis which all realize and acknowledge, I appeal to you all to co-operate for the ultimate good of the whole world.

'It cannot be beyond the power of man so to use the vast resources of the world as to ensure the material progress of civilization. No diminution in those resources has taken place. On the contrary, discovery, invention and organization have multiplied their possibilities to such an extent that abundance of production has itself created new problems. And, together with this amazing material progress, there has come a new recognition of the interdependence of nations and of the value of collaboration between them. Now is the opportunity to harness this new consciousness of common interests to the service of mankind.'

Perhaps the most remarkable feature of Mr. MacDonald's opening speech was the frankness with which he referred to the war debts problem.[1] The Conference itself could not consider the matter, but it 'must be dealt with before any obstacle to general recovery has been removed, and it must be taken up without delay by the nations concerned'. The Prime Minister's peroration was gravely impressive to his hearers, though it raised the grim smile of cynicism when re-read a month or two later.

[1] See above, p. 145.

'The fate of generations [he said] may well depend upon the courage, the sincerity, the width of view which we are to show during the next few weeks.'

In their magnitude and urgency the problems before the Conference were, indeed, as inspiring to some as they were disheartening to others.

The gathering total of international defaults showed how unbearable had become the load of debts when prices were wretchedly low and when creditor countries with their rising tariffs penalized payment. Only a few days before the Conference opened Germany had declared a transfer moratorium on long-term debts. World tariffs were still mounting, reinforced by quotas and exchange control. Sterling and many associated currencies were detached from gold, the dollar was moving in an orbit of its own, the currencies of Central and Eastern Europe were confined in the poor-house of exchange control, and virtually only France, Belgium, Poland, Switzerland, and the Netherlands, with their dependencies, still shared the cold comfort of the international gold standard. Unemployment threatened the great industrial countries with social demoralization. Yet, to those who knew how to read the portents, the darkness of the storm was giving way to the grey drizzle of tentative and precarious recovery—a fact that had been recognized by the preparatory commission of experts.

It is not easy to assess the reasons for this incipient economic recovery. It was not entirely world-wide, but was largely concentrated in the countries whose currencies were relatively depreciated. This suggests that part of their benefit was gained at the expense of others; but that is only a fraction of the truth. The liberation of their currencies from former external strains, besides giving them a competitive advantage in trade, also enabled them to pursue with greater zeal and completeness policies designed to increase internal purchasing power. First among such policies was the maintenance of low money rates. In Great Britain, certainly, the combination of cheap money and changing business opportunities through the alteration of fiscal policy was the mainspring of national economic revival. In the United States, easy monetary conditions were perhaps of less immediate importance, in initiating recovery,

than the expectation of governmental inflation through budget deficits and public works. It was the expectation rather than the fact of inflation that caused the rise of American prices between March and June 1933. American enthusiasm was not internationally infectious; indeed, the rapid fall of the dollar in comparison with gold and sterling currencies threatened to exert a deflationary influence on world prices. On the other hand, the United States represented an important market for most industrial raw materials—the principal market for many—and her industrial recovery meant for her suppliers an expanding demand and a rising national income.

The rise in prices in the United States and elsewhere was accelerated by the depletion of overhanging stocks that had taken place in certain commodity markets. This, it is true, was not yet a very noticeable feature of the economic world, especially as it was consumers' rather than producers' stocks that had run down; but by 1932 the decline in world output of commodities other than cereals generally exceeded the compression in the demand for them.

Other economic adjustments, international and internal, were taking place simultaneously and strengthening the foundations of recovery. In spite of the still lengthening list of defaults, the international debt burden had grown somewhat easier, by reason both of the funding or repatriation of capital and of the relief to debtors provided by the depreciation of the pound and the dollar. Debtor countries, meanwhile, had gone a long way towards restoring their external financial position by learning to do without imports. In each national economy the fall in personal incomes was bringing about a decline in the proportion of saving to consumers' expenditure; the need for providing against the perils of the future was overborne by present demands for the replacement of outworn clothing, furniture, motor-cars, and other chattels. What was true of individuals applied also to industrial and commercial firms. Some depleted their reserves in order to maintain dividend appropriations. Many were forced by conditions of intensified competition to purchase new machinery and fresh stocks of raw materials. Meanwhile, the shift of demand was creating opportunities for new investment even

as it debased former capital values. Some trades, furthermore—most obviously those, like catering and the production of branded goods, which could take advantage of low raw material prices without feeling any strong pressure to lower the prices of their products—flourished even in depression, and these too made calls, for the purpose of investment, on the diminished flow of savings.

It seems unlikely that the leading statesmen who took part in the London Conference were fully aware of these tendencies towards economic recovery. Their eyes were on the storm, not on the rift in the clouds. That made no difference to the problems that they all acknowledged themselves to be facing. Whether trade was on the mend or not, it needed the tonic of greater international freedom. So much the assembled statesmen would all have admitted, but willing the end did not imply approving the necessary means, or even agreeing on their nature. In particular, there was a sharp clash of opinion between those—like the French—who held that the restoration of an international monetary standard must precede the lowering of tariff barriers, and those—like the British—who held that any such standard would be threatened with imminent breakdown unless the forces that had smashed the gold standard, including excessive tariff barriers, were first subdued. Perhaps the paradox was insoluble; but, when the Conference opened, public opinion in Europe generally believed that a compromise might be found in a temporary stabilization of the exchanges *de facto*.

The speeches of the delegation leaders at the first public session of the Conference varied widely in their emphasis upon the different problems to be tackled. Currency stability was mentioned by most of the delegates, but in widely varying terms. 'How are we to restore the circulation of goods,' asked Monsieur Daladier (France), 'how are we to make durable economic agreements, if the measure of value continues to depend on hazard or chance?' Signor Guido Jung (Italy) recalled with approval the Genoa Conference's warning against 'the dangers and delusions connected with the depreciation of currency', and its advocacy of a rapid return to gold. 'We might try in the first instance', said Monsieur Colijn (Nether-

lands), 'to devise means whereby the fluctuation in the value of currencies may be kept within certain limits.' Poland, through Monsieur Koc, suggested another form of gradualism. 'We should start by stabilizing the currencies of the Great Powers, which exercise a decisive influence on the international financial market.' Mr. R. B. Bennett, the Prime Minister of Canada, presented an even more limited objective, urging 'that the two greatest trading and creditor countries should, at the earliest possible moment, reach an agreement upon a *de facto* stabilization of their exchange rates'.

What, then, were the views of the two great countries to which Mr. Bennett referred? Mr. Chamberlain expressed at length the established eclecticism of British policy. Stability of exchange rates must be reached in two stages. 'The immediate objective should be to secure approximate stability between the currencies of the principal countries of the world. . . . This first stage should be dealt with immediately. As regards the second stage, the United Kingdom delegation endorse the view that the ultimate aim of monetary policy should be the restoration of a satisfactory international standard, and there is no doubt that a gold standard seems to be generally acceptable.' He then mentioned certain conditions that would have to be fulfilled before the United Kingdom would feel justified in returning to the gold standard. They included a rise in the price level 'sufficient to restore equilibrium between prices and costs', a war debt settlement, the reduction of tariff barriers, and the reform of the machinery of the gold standard. This policy differed in no essential particulars from that expressed by Mr. Cordell Hull on behalf of the United States. 'In the monetary field', said Mr. Hull, 'suitable measures must be taken to provide for an immediate policy which will give the greatest possible measure of stability for the period during which the groundwork will be laid for enduring reform. . . . The Conference must face the vexed problem of a permanent international monetary standard.' The Japanese Government were likewise prepared to consider 'appropriate measures for the obviation of exchange fluctuations, as an interim step pending the final return to the gold standard'.

These opening speeches betrayed greater differences of opinion on the subject of tariff reduction than they betrayed on that of currency stabilization. Of course, almost every national spokesman stressed the vital need for a lowering of tariff barriers throughout the world, but few mentioned any means of achieving that aim, and where they did they were generally at loggerheads. Several, for instance, like Viscount Ishii, emphasized the necessity for retaining the most-favoured-nation clause in full vigour. For Argentina, Dr. Le Breton declared that 'any preference of a political nature, or any regional discrimination, must be definitely condemned'. On the other hand, several voices were heard demanding derogations from the most-favoured-nation principle. Thus Mr. Bennett called attention to 'the fact that where most-favoured-nation agreements are of long standing they frequently destroy or greatly lessen the value of a recently negotiated bilateral agreement'. The Little Entente Powers, said Dr. Beneš, upheld 'the principle of general ratification of the most-favoured-nation clause, while being prepared to agree to expressly stipulated derogations from that clause'. Belgium and the Netherlands pleaded for the principle of the Convention of Ouchy, which involved a waiving of most-favoured-nation rights by other countries. Mr. Chamberlain, however, offered no encouragement. 'The United Kingdom Government would find it difficult to agree to any formula allowing derogations from most-favoured-nation treatment in respect of regional or group agreements (falling short of customs unions), except those based on historical associations such as are already generally recognized. Apart from this, however, they would, without committing themselves in advance, be prepared to examine on their merits specific proposals for temporary and limited exceptions which are accepted by other countries entitled to most-favoured-nation treatment, and which are not prejudicial to British interests.' 'Most-favoured-nation treatment', however, declared the Chancellor of the Exchequer, 'cannot be maintained to countries which now enjoy its benefit unless they are willing to adopt a reasonable policy in framing their own tariffs and in negotiating new agreements.'

The British Government's view was that a reduction of

customs tariffs could best be achieved by a series of bilateral negotiations taking detailed account of the particular trade relations of the negotiating countries. The United States, on the other hand, favoured multilateral action. Mr. Cordell Hull asked for immediate general adherence by all participating Governments to the tariff truce. The basic idea of the tariff truce was elaborated by Monsieur Litvinov, the chief Soviet delegate, in his advocacy of a 'pact of economic non-aggression'. The types of economic warfare that he denounced included 'all methods of discrimination, tariff wars, covert or overt, currency wars, the discriminatory prohibition of imports and exports, and all forms of official boycott'. A special plea for the abolition of state subsidies to private enterprise, especially export subsidies and shipping subsidies, was put forward on behalf of the United Kingdom, but mention of this issue was significantly avoided by the representatives of other Great Powers, unless we may regard it as covered by Mr. Cordell Hull's 'All unfair trade methods and practices should be abandoned'. Bulgaria, through Monsieur Malinov, called 'for the abolition of the agrarian protectionist system which has been so intensified in most of the industrial countries in Europe, and also for the abolition of restrictions on transit'. Dr. Kallas, for Estonia, very plausibly insisted that creditor countries should take the initiative in moderating their tariffs.

The reduction of trade barriers was, indeed, closely associated with the problem of international debts. Most of the additions to such barriers during the course of the world slump had been designed either by debtor countries to make possible the payment of their debts or by the creditor countries to evade the commercial consequences of being paid. The debtor countries were naturally the more forward in proposing revision. Bulgaria, for instance, declared that the equilibrium of her balance of payments and the stability of her currency required 'the total suppression of reparations debts and the reduction of her external debt in proportion to the country's capacity of payment'. 'It does not seem possible to escape the conclusion,' said Mr. G. W. Forbes, the Prime Minister of New Zealand, 'that unless commodity prices can be raised so substantially as to reduce the real burden of existing public

and private debts, there must be a general scaling down of these debts. Indeed, such action may in any case be necessary, not as an alternative but in addition to the raising of the price level.'

There was a wide difference of opinion among the delegates regarding the possibility of a considerable rise in world commodity prices. On the one hand, views were expressed like those of Monsieur Koc (Poland), who held it dangerous 'to place too blind a faith in the possibility of any general improvement in prices. This danger would', he added, 'be particularly great if it led us to lose sight of those capital and fundamental solutions which are necessary—namely, the stabilization of currencies, the rearrangement of debts, and the re-establishment of commercial free trade.' On the other hand, Great Britain and other countries took the line that a rise of prices was the condition of currency stabilization and of substantial tariff reduction, and would render unnecessary the difficult and damaging readjustment of debts.

How was a rise of prices to be brought about? The belief of the British Government was that action must be taken in the financial sphere by the abrogation of exchange controls, for example, and the resumption of international lending; and also in the economic sphere, by such means as the co-ordination of production and marketing, the removal of prohibitions and similar barriers, and the reduction of excessive tariffs. Action was also necessary in the monetary sphere. 'The fundamental monetary condition of the recovery of prices is that credit should be made available by a policy of cheap money, and that such credit should be actively employed.' The Conference was not, however, by any means unanimously agreed upon the value of such monetary stimulation. Signor Jung, for instance, declared that, in the opinion of his Government, not merely were monetary manœuvres not a cure, but in the end they would make things worse for every one. 'It is not logical to deplore an excess of productive equipment and at the same time to promote an expansion of that equipment by forced injections of credit.'

The Italian spokesman nevertheless acknowledged that 'emergency measures intended to increase consumptive

capacity and prompted by considerations of a social character' were perfectly justified, though their effect could be only temporary. The question of public works was touched upon by several delegates. On behalf of the International Labour Organization, Sir Atul Chatterjee put forward a programme adopted by the International Labour Conference then sitting, which included a proposal to restore circulation to idle capital, notably by the inauguration of large-scale public works, associated with international lending. The French delegation were the most notable supporters of this programme. The experience of the nineteenth century, said Monsieur Daladier, had shown that public works on an extensive scale made it possible to mobilize hoarded capital and to render more easy and beneficial the activities of the nations.

Alongside such basically inflationary policies as cheap money and large-scale public works, several delegations advocated the opposite expedient of raising particular prices by means of the regulation of production. 'Production must be adjusted', said Monsieur Daladier, 'to the real possibilities of consumption.' Dr. Dollfuss, the Austrian Chancellor, argued that when the exporting countries had raised the price by regulating their production, the importing countries could then lower their tariffs without risk to their farmers. It remained for the British Dominions, especially Australia and New Zealand, to sound the note of opposition. Producers in New Zealand, said Mr. Forbes, were most reluctant to agree to limitation either of exports or of production. They looked to the removal of barriers, and to the restoration of purchasing power, for the absorption of increasing supplies. Amid so much reference to over-production, very few voices were heard in support of Monsieur Daladier's proposal that the regulation of supply should be supplemented by 'a great effort in the organization of labour and power, and especially by the introduction of an international framework of the reduced working week—a working week reduced, for instance, to forty hours'.

It has been necessary to record in some detail the views of the various delegations upon the principal issues before the Conference, in order to lay bare the extent of difference among

them. There was clearly not one division of opinion, but many. Moreover, before responsibility can be apportioned between the different participating countries, one general question requires an answer. How did it happen that, a year after the preparations for the Conference had begun, there should remain such critical divergences of opinion both as to the purposes to be achieved and as to the programme to be followed? With somewhat naïve optimism, General Smuts proposed in his opening speech that 'the purely financial and economic difficulties' should at once be relegated to expert committees. When these committees had reported, the members of the Conference 'should not make too much of their political difficulties', but should 'face the issue fairly and courageously on its merits'. Unhappily, at the end of six months of study and discussion the experts themselves had been able to produce but a vague and equivocal report. Their differences, and the incapacity of Governments to reach a common decision even where the experts were unanimous, could alike be traced to the organic intimacy of the connexion between economics and politics. The advice of the economic experts could not by itself solve the problems before the World Economic Conference; it could only estimate the probable consequences of projected solutions. The economists were merely in the witness box. It was for the politicians to occupy the Bench.

It was decided at the opening session to set up a Bureau which would act as a steering committee and as an executive for the Conference. The Bureau consisted of a representative from each of the following countries: Argentina, Canada, China, Czechoslovakia, France, Germany, Hungary, Italy, Japan, Mexico, the Netherlands, Spain, Sweden, the United Kingdom, the United States, and the U.S.S.R. The committee organization was eventually as follows:

Monetary and Financial Commission

Sub-Commission I (Immediate Measures for Financial Reconstruction)

Sub-Commission II (Re-establishment of an International Monetary Standard)

Sub-Committee 1 (Silver)

Sub-Committee 2 (Technical Monetary Questions)

Economic Commission

Sub-Commission I (Commercial Policy)
Sub-Commission II (Co-ordination of Production and Marketing): Sub-Committees on Coffee, Sugar, Wine, Timber, Tin, Dairy Products and Wheat
Sub-Commission III *a* (Subsidies and Merchant Shipping)
Sub-Commission III *b* (Indirect Protectionism)

On the 15th June Mr. Cordell Hull broadcast a message to the United States in the course of which he said: 'The correction of inordinate tariff and other restrictions and obstructions and the stabilization of exchange must be accomplished if there is any lasting good to be reached by this congress of nations.' On the same day it was unofficially but authoritatively reported that an understanding on the subject of currency stabilization had been reached in the course of conversations in London among representatives of the Bank of England, the Bank of France, and the Federal Reserve system. No account of these conversations suggested that an immediate return to the gold standard or any other unalterable fixation of the dollar's exchange value was contemplated. On the 17th June, however, the President rejected the agreement. The United States Government, said the acting Secretary of the Treasury, were willing to listen, but did not wish to be placed in the position of trying to reach a deal. No counter-proposals would be made by the American delegation to take the place of the terms rejected by the President. Nevertheless, European opinion did not consider that stabilization had been ruled out, in view of the unambiguous statements that had been made in its favour by the President himself.

This belief that stabilization of some kind would shortly be accomplished was encouraged by the fact that, on the 19th June, Senator Key Pittman, deputy leader of the United States delegation, introduced a draft resolution of which the following were the opening words:

'Whereas confusion now exists in the fields of international exchange, and,

'Whereas it is essential to world recovery that an international monetary standard should be re-established,

'Now, therefore, be it resolved that all the Nations participating in this Conference agree:

(*a*) That it is in the interests of all concerned that stability in the international monetary field be attained as quickly as practicable;

(*b*) That gold should be re-established as the international measure of exchange values.'

There followed paragraphs in favour of the reform of the gold standard, along the lines indicated by Mr. Chamberlain.

The public, however, had already learnt to distrust individual expressions of American policy. On the 17th June Mr. Cordell Hull had submitted the text of suggested agenda for the Economic Commission, in the field of commercial policy. The draft began with a proposal for a 'ten per cent. horizontal reduction of import duties (and preferences) in effect in the various countries'. When, however, this document came to the notice of Senator Pittman, he categorically denied that any proposal for an all-round cut of 10 per cent. in tariffs had been submitted by the American delegation.

It was at this juncture that Mr. Roosevelt decided to send Mr. Raymond Moley, the Assistant Secretary of State, to London 'to convey to Secretary Hull and the members of the delegation his impressions of the development of the domestic situation both with respect to the actions of Congress, the development of administrative policy, and the general economic situation of the country'. This was naturally interpreted as a sign that the President had been forced to bow to the inflationism of Congress and the American people.

Meanwhile, discussions on the subject of stabilization were proceeding among the leading delegations. On the 22nd June the American delegation issued the following statement:

'Undue emphasis has been placed upon consideration of the plan proposed for temporary *de facto* stabilization of currencies. The fact is that this was never an affair of the delegation. It was considered by representatives of the Treasuries and Central Banks of the United States, Great Britain and France, Dr. Sprague having been especially sent to represent the United States Treasury for this purpose. The American Government at Washington finds that measures of temporary stabilization now would be untimely.

'The reason why it is considered untimely is because the American Government feels that its efforts to raise prices are the most important contribution it can make, and that anything that would interfere with those efforts and possibly cause a violent price recession would harm the Conference more than the lack of an immediate agreement for temporary stabilization.

'As to the ultimate objective, the American delegation has already introduced a resolution designed for ultimate world-wide stabilization of unstable currencies, and is devoting itself to the support of measures for the establishment of a co-ordinated monetary and fiscal policy to be pursued by the various nations in co-operation with each other, for the purpose of stimulating economic activity and improving prices.'

Certain Governments were now urging the suspension of the Conference. But some last hopes were attached to the visit of Mr. Moley, who was thought to be in a position to inform the American delegation under what conditions stabilization could be contemplated. In this atmosphere of doubt and misunderstanding, the Conference went forward. The exchange situation grew ever more difficult. The dollar fluctuated violently, with a steadily downward tendency, as rumour succeeded rumour. Powerful agitation was aroused in France for immediate withdrawal from the discussions. All agreed that unless the dollar was stabilized against the pound, the pound could not be stabilized against gold currencies. Failure to stabilize the dollar thus seemed to hold out a double threat to the gold standard in the few remaining countries where it was still upheld; hence a bear movement was initiated against the guilder and to a less extent against the Swiss franc. In a week the gold stocks of the Netherlands Bank fell from 834,700,000 guilders (£69 millions) to 791,800,000 guilders (£65 millions). On the 28th June the Netherlands Bank raised its discount rate from $3\frac{1}{2}$ to $4\frac{1}{2}$ per cent. The run on the guilder precipitated a move towards the formal organization of a 'gold bloc'. The representatives of the gold countries—Belgium, France, Italy, the Netherlands, and Switzerland—met on the 29th June, and again on the following day, to formulate a joint policy, which they urgently pressed upon Mr. MacDonald and the British delegation.

Meanwhile Mr. Moley had arrived in London. His public

statements about the prospects of stabilization were not encouraging, and he was reported to have been even more negative in his conversations with the United Kingdom leaders. On the other hand, the representations of the gold countries were urgent. Their financial and monetary stability was imperilled, they said, by the continuance of uncertainty. Stabilization was admittedly out of the picture for the moment, but at least a reassuring declaration would check the speculators and arrest the wilder rumours. On the 30th June, therefore, as a result of conversations among the different parties, a compromise declaration was drawn up and submitted to the President. The following is the text of the draft:

Draft Joint Declaration by the Governments of the Countries on the Gold Standard and by those which are not on the Gold Standard.

'I. The undersigned Governments agree that:

(*a*) it is in the interests of all concerned that stability in the international monetary field be attained as quickly as practicable.

(*b*) that gold should be re-established as the international measure of exchange value, it being recognized that the parity and time at which each of the countries now off gold could undertake to stabilize must be decided by the respective Governments concerned.

'II. The signatory Governments whose currencies are on the gold standard re-assert that it is their determination to maintain the free working of that standard at the existing gold parities within the framework of their respective monetary laws.

'III. The signatory Governments whose currencies are not on the gold standard, without in any way prejudicing their own future ratios to gold, take note of the above declaration and recognize its importance. They re-affirm as indicated in Paragraph I above that the ultimate objective of their monetary policy is to restore, under proper conditions, an international monetary standard based on gold.

'IV. Each of the signatory Governments whose currencies are not on the gold standard undertakes to adopt the measures which it may deem most appropriate to limit exchange speculation, and each of the other signatory Governments undertakes to co-operate to the same end.

'V. Each of the undersigned Governments agrees to ask its central bank to co-operate with the central banks of the other

signatory Governments in limiting speculation in the exchanges and, when the time comes, in re-establishing a general international gold standard.

'VI. The present declaration is open to signature by other Governments whether their currencies are on the gold standard or not.'

It will be observed that the first clause of this declaration repeated the words of Senator Pittman's resolution.

On Saturday, the 1st July, the President informed Mr. Hull that he had rejected the joint proposal 'in its present form'. The Conference might thus have been excused for expecting from the President some amendment indicating in what form it would be acceptable. Instead, Mr. Hull presented, on the 3rd July, the following rather petulant statement, which the President himself had substituted for the diplomatic draft suggested by the Secretary of State:

'I would regard it as a catastrophe amounting to a world tragedy if the great Conference of nations, called to bring about a more real and permanent financial stability and a greater prosperity to the masses of all nations, should, in advance of any serious effort to consider these broader problems, allow itself to be diverted by the proposal of a purely artificial and temporary experiment affecting the monetary exchange of a few nations only. Such action, such diversion, shows a singular lack of proportion and a failure to remember the larger purposes for which the Economic Conference originally was called together.

'I do not relish the thought that insistence on such action should be made an excuse for the continuance of the basic economic errors that underlie so much of the present world-wide depression.

'The world will not long be lulled by the specious fallacy of achieving a temporary and probably an artificial stability in foreign exchanges on the part of a few large countries only.

'The sound internal economic system of a nation is a greater factor in its well-being than the price of its currency in changing terms of other nations.

'It is for this reason that reduced cost of Government, adequate Government income, and ability to service Government debts are all so important to ultimate stability. So, too, old fetishes of so-called international bankers are being replaced by efforts to plan national currencies with the objective of giving to those currencies a continuing purchasing power which does not greatly vary in

terms of the commodities and needs of modern civilization. Let me be frank in saying that the United States seeks the kind of dollar which a generation hence will have the same purchasing and debt paying power as the dollar value we hope to attain in the near future. That objective means more to the good of other nations than a fixed ratio for a month or two in terms of the pound or franc.

'Our broad purpose is the permanent stabilization of every nation's currency. Gold or gold and silver can well continue to be a metallic reserve behind currencies, but this is not the time to dissipate gold reserves. When the world works out concerted policies in the majority of nations to produce balanced budgets and living within their means, then we can properly discuss a better distribution of the world's gold and silver supply to act as a reserve base of national currencies.

'Restoration of world trade is an important partner both in the means and in the result. Here also temporary exchange fixing is not the true answer. We must rather mitigate existing embargoes to make easier the exchange of products which one nation has and the other nation has not.

'The Conference was called to better and perhaps to cure fundamental economic ills. It must not be diverted from that effort.'

Naturally, the agitation for the termination or suspension of the Conference was redoubled, not only in the gold countries, whose policy had been frustrated, and who mortally feared the exchange speculation to which the manœuvres of the Conference gave rise, but also in Great Britain. The Conference, indeed, though nominally at work, was actually in suspense. When the Bureau met on the 4th July, a motion for adjournment was expected from one of the gold countries. Mr. Hull, however, intervened in order to postpone the issue; and on the following day the American delegation, doubtless far from anxious to accept responsibility for the break-down of the Conference, issued a new explanatory statement.

The revaluation of the dollar in terms of American commodities (ran this document) was an end from which the Government and the people of the United States could not be diverted. What was to be the value of the dollar in terms of foreign currencies would ultimately depend upon the success of other nations in raising prices in terms of their national

moneys. After prices had been raised, the next task was to preserve stability. The part that gold and silver should play, once the adjustment had been secured, was a further subject suitable for consideration by the Conference. The great problems that had justified the assembling of the nations were as present then and as deserving of exploration as they had been a few weeks previously; and it was difficult to conceive why the American view on 'this minor issue of temporary stabilization' could in any way diminish the advisability of such discussion.

This pronouncement helped to keep the Conference in being, though the gold standard Powers were far from being mollified. On the 6th July the Bureau adopted the following resolution:

'Whereas the Bureau is firmly determined to proceed with the work of the Conference to the utmost possible extent and as rapidly as possible;

'And whereas, on account of circumstances which have recently arisen, the countries on the gold standard find themselves obliged to declare that, for the time being, it is impossible for them to take part in any discussion of monetary questions, the Bureau agreed unanimously to:

(*a*) Request each sub-committee to meet as soon as possible to draw up a list of the questions which can in these circumstances be usefully studied by it;

(*b*) Meet as soon as the reports of the sub-committees have been received, in order to make recommendations as to the arrangements which should be made for the further business of the Conference.

The work that was subsequently performed was desultory and half-hearted, except in certain special fields like wheat restriction and silver marketing. One of the few remaining possible lines of achievement was blocked when, in a debate on international public works schemes, Mr. Runciman announced the flat refusal of the United Kingdom Government to participate. The question of dealing with unemployment by means of public works expenditure, in their view, was one for each country to decide for itself, but for their part they were abandoning the policy once and for all. Another path was

stopped up when the American delegation, acting in accordance with the views of the Federal Reserve Board, refused to consider more than the principle of central bank co-operation.

On the 14th July, only three days after the residual programme had been drawn up, the Steering Committee of the Bureau bowed to the inevitable, deciding to ask the various sub-committees to conclude their work not later than the 21st July. There would then be plenary sessions of the two main Commissions, and on the 25th July the Bureau would meet and call a plenary session of the full Conference with a view to an adjournment. These arrangements were carried out. On the recommendation of the Bureau, the Conference adopted a resolution empowering the President, Vice-President, and Bureau to take whatever action they might consider likely to promote the success of the Conference—for instance, the convocation of special committees—and to determine the date of reassembly. Mr. Cordell Hull urged in vain that the Bureau should be enjoined to meet not later than the 1st November to fix the date for the new session.

The work already performed by the Conference in committee, though comprehensive in scope, was sadly indecisive in content. The pursuit of what many considered the principal object of the occasion, the liberation of trade, was diffident and uninspired. France and the other gold countries protested that nothing could be done until currencies had been stabilized. Even apart from that, however, the Economic Commission seemed, in retrospect, hopelessly divided and leaderless on the vital question of deciding by what process trade barriers were to be reduced. Some delegates leaned towards the suggestion of an all-round 'horizontal' cut in tariffs, which others denounced as unduly penalizing low-tariff countries. There were various suggestions for the prolongation of the tariff truce, though again the objection was raised that such measures would tend only to stabilize the existing evil state of things. The British delegation reiterated their faith in bilateral agreements, a view that was opposed by several other countries. The Belgian delegation, for instance, held that the method of bilateral negotiation would serve only to favour highly protected states. The Polish delegation

proposed that bilateral agreements should be supplemented by a multilateral convention based on the principles of the Ouchy Convention. A protracted debate on the most favoured-nation clause exposed wide differences of opinion.

While the attempt to secure a reduction of customs tariffs was thus bogged in generalities, greater progress might perhaps have been expected in the campaign against prohibitions and other abnormal restrictions on trade. Here too, however, the failure to stabilize exchanges led the gold countries to adopt a somewhat intransigent attitude. It was mainly for the same reason that very little progress was recorded by the sub-committee on subsidies, though the American delegation left no room for doubt concerning their country's firm intention to retain its policy of subsidies to shipping. A number of proposals were offered for the relaxation of non-tariff restrictions on trade, including a Dutch proposal for the abolition of all quantitative restrictions. Perhaps the fundamental reason for the want of progress in this sub-commission was the reluctance of individual Governments, while joining in the general denunciation, to abolish the particular forms of restriction that suited their commercial policy. The French delegation, for instance, asked for an exception in favour of agricultural quotas and prohibitions—a proposal most vigorously opposed by the agricultural exporting countries. The United Kingdom delegation moved:

'(1) That all import prohibitions should be abolished except those admitted by international agreement;

'(2) That a very definite distinction should be drawn between import quotas arbitrarily fixed for protectionist purposes, and production or marketing quotas established by international agreement with a view to the raising of prices;

'(3) That the greatest importance should be attached to the abolition of arbitrarily established import quotas.'

The form of exception suggested was criticized by several delegations. It was, indeed, easier to justify in theory than to apply in practice. For instance, when, in the summer of 1933, the British Government inaugurated their scheme for the marketing of bacon, they secured the concurrence of Denmark, the principal external supplier, in a plan for cutting

imports of bacon by 20 per cent., with a view to raising the price; but when a few months later the market was menaced by an unexpectedly large home production, imports were again cut by 16 per cent., despite the objections of the Danish producers. The former of these two measures would presumably have been allowed and the latter condemned under the British Government's own classification.

Their belief in the restriction of production was made very plain in the sub-commission on 'the co-ordination of production and marketing'. The question of the control of production, said Mr. Runciman, played a great part in the policy of the United Kingdom, who sought by this means to raise prices not only in her own domain but throughout the world. In this attitude he was strongly supported by the representatives of France and Italy. Monsieur Sarraut (France) declared that the first task of the Conference was to put an end to the chaos in production, which was the root cause of the crisis. The sub-commission adopted the following resolution:

'1. In order to assist in the restoration of world prosperity, it is essential to increase the purchasing power of the producers of primary products by raising the wholesale prices of such products to a reasonable level.

'2. In the exceptional conditions of the present world crisis, concerted action is required for this purpose. Apart from any other measures that may be taken to restore the purchasing power of producers and consumers and thus to increase demand, it is desirable that plans should be adopted for co-ordinating the production and marketing of certain commodities.'

The resolution proceeded to lay down conditions to which such plans should conform. These included comprehensiveness, both as regards competitive products and as regards different groups of producers; fairness to all parties, both producers and consumers, the co-operation of the latter being obtained if possible; adequate duration, and flexibility. Mr. Stanley Bruce said that the Australian delegation would have preferred the words 'it may be necessary' to the words 'it is desirable' in paragraph 2. Australia, said Mr. Bruce, viewed restriction as a policy of pessimism. Under schemes to restrict production to existing demand, she would fail in her duty to

the world for the development of a great continent, and would find it difficult to carry out her external obligations.

The conclusions of the Commission with regard to individual commodities were as follows. The International Institute of Agriculture, in conjunction with other international bodies concerned, was requested to make a preliminary study of the question of dairy products. The Bureau of the Conference was requested to keep in touch with the International Sugar Council and with the countries concerned in the production of sugar, and to summon, when it should think expedient, a further meeting for the conclusion of a general agreement. With regard to wine, the sub-commission recommended further investigation by the International Wine Office, at the same time pointing out certain necessary lines of action. To the chief producers of coffee, cocoa, and copper was left the task of making suggestions to the Secretary-General of the Conference for the international organization of the markets in those commodities. Useful negotiations, it was noted, were already in progress in the timber trade. The principal producers of coal were recommended to endeavour to organize production on an international basis, under the auspices of the League of Nations. As for tin, the sub-commission noted with approval the work of the International Tin Committee, and recommended that the countries producing the metal in appreciable quantities, but not already participating in the control scheme,[1] should apply for appropriate quotas.

The most interesting negotiations, however, were those relating to wheat. They were not originally part of the official transactions of the Conference, having been initiated by direct contacts among representatives of the chief producing countries; but they were popularly regarded as part of the Conference's work, their progress was officially noted, and the resultant agreement was published as a Conference document. Their success owed much to the energy of Mr. R. B. Bennett, the Prime Minister of Canada. The plan also fitted well into American policy. Argentina, impoverished by low

[1] Those mentioned were: Australia, Belgium, China, France, India, Japan, Mexico, Portugal, South Africa, and the United Kingdom.

prices obtained for her crops, was acquiescent, though her capability of enforcing restriction was always in doubt. Australia, however, raised the most stubborn opposition. Her solvency, her duty to the world to develop her vast open spaces, said Mr. Bruce, depended on widening and not contracting markets. The agreement that was initialed on the 25th August took account of Australia's attitude in confining restriction to exports, leaving the question of acreage limitation to individual Governments, and in insisting that, as restriction achieved a rise of prices, importing countries must reduce their barriers against imports of wheat. Details of the agreement are reported on p. 231, below.

In the Monetary Commission, Mr. Chamberlain initiated a general debate by moving a resolution on the lines of his opening speech. The most cordial support for a policy of raising prices by keeping money cheap came from the British Dominions, and from other primary producing countries. On the other hand, France and others claimed that, while cheap money was essential, the main obstacle to a rise of prices was the hoarding of capital, which only a restoration of confidence could undo. Without stable currency, said Monsieur Bonnet, there could be no lasting confidence. 'Who would be prepared to lend, with the fear of being repaid in depreciated currency always before his eyes?' This division of opinion was repeated in the discussion on international indebtedness. Mr. Chamberlain denied that, pending a general rise in world prices, there was any need for a permanent reorganization of either short-term or long-term debts, as some of the debtor countries proposed. Sir Henry Strakosch (India) declared that if the Conference called for a permanent reduction of debts it would be exposing belief in its own failure. The way to lighten debts without destroying credit was to raise prices.

Oddly, it was in the other monetary sub-commission, which dealt with the working of the gold standard and the operations of central banks, that there was outwardly the greatest measure of agreement in the Conference. The sub-committee on 'permanent measures' passed not only the Pittman resolutions on the restoration of exchange stability,

but also a resolution on the operation of the gold standard admitting the undesirability of having gold coins or gold certificates in circulation, and suggesting that 25 per cent. was a sufficient minimum ratio for gold reserves. Another resolution expressed the opinion that independent central banks should be created in such developed countries as were still without them. The sub-committee also adopted important resolutions on the principles of central banking policy, laying stress on the need for central banks to recognize that in addition to their national tasks they had also to fulfil a task of an international character. The only dissentient voice was that of the United States, who thought that discussion of the question of central bank policy was premature.

More immediately practical results emerged from the discussion on silver. A series of resolutions introduced by Senator Pittman[1] proposed, first, that an agreement be sought between the chief silver-producing countries and those countries which were large holders or users of silver, with the purpose of limiting arbitrary sales on the world market. Secondly, all nations were to renounce the further debasement of their silver coinage, and to promise to increase the silver fineness of their subsidiary coins as soon as finances should permit. It was further suggested that central banks might agree to keep 80 per cent. of their metal cover in gold, and the remainder either in gold or in silver. These proposals, with the exception of the last, were accepted by the sub-commission, and in accordance with the first of them the United States, Mexico, Peru, Canada, and Australia provisionally agreed with India, China, and Spain upon certain measures designed to bring greater strength and stability to the silver market. Over the four-year period during which the agreement was to operate, the Indian Government would limit their sales of reserve silver to 140 million ounces, while the five first-named Governments undertook to arrange for the withdrawal from the open market of a similar quantity of silver won from their mines. Spain agreed to limit sales to not more than 5 million ounces annually, and China promised not to sell any silver from

[1] But largely formulated and advocated by Sir George Schuster, then Finance Member of the Executive Council of the Viceroy of India.

demonetized coins. Silver sold to cover war debt transfers was excluded from these terms.

There remains to be recorded one other achievement of major importance, which, though likewise outside the scope of the Conference proper, was made possible by the assembly of the nations to discuss economic affairs. That was a joint declaration signed by the delegates of all the British countries there represented except the Irish Free State. They reiterated their faith in the value of the Ottawa Agreements, on the ground that these would not only facilitate the flow of goods within the Empire, but would also stimulate and increase the trade of the world. The policy of the British Commonwealth, they declared, had been directed to raising prices, at first in opposition to the fall in gold prices. During the past few months the persistent adherence of the United Kingdom to a policy of cheap and plentiful money had been increasingly effective. The signatories considered that the Governments of the Commonwealth should persist by all means in their power, whether monetary or economic, within the limits of sound finance, in the policy of furthering the rise in wholesale prices until equilibrium had been re-established, whereupon they should seek to stabilize the position thus attained. The ultimate aim of monetary policy should be the restoration of a satisfactory international gold standard, subject to international co-operation for avoiding undue fluctuations in the purchasing power of gold. In the meantime the signatories recognized the importance of stability of exchange rates between the countries of the Commonwealth, in the interests of trade. That objective would be constantly borne in mind in determining their monetary policies. Its achievement would be facilitated by the fact that the United Kingdom Government had no commitments to other countries regarding the future management of sterling. The adherence of non-British countries to a price-raising policy would make possible the maintenance of exchange stability over a still wider area. The signatory delegations agreed to recommend their Governments to consult with one another from time to time on monetary and economic policy.

The practical results of the Conference proper were thus

negligible. Even the agreements on wheat and silver were initiated by self-constituted groups of interested countries, and were arranged for the most part in the course of private conversations. The Conference as a whole met only to inaugurate itself and to wind itself up. While the rather half-hearted debates were proceeding in committee, the attention of the delegates was distracted by the currency squabble, in which few of them had any part, and concerning the course of which most of them knew as little as any newspaper-reader. Many representatives of smaller states therefore returned home not only disillusioned but completely bewildered.

A note of profound disappointment naturally ran through the speeches made at the final plenary meeting. Some delegates, indeed, tried to put the best possible face on the matter. Mr. MacDonald laid emphasis on the fact that the Conference was but adjourning. Monsieur Bonnet expressed his belief that frank co-operation would have enabled the nations to bring a more enlightened and more generous judgement to bear upon each other's difficulties. Signor Jung also stressed the prophylactic qualities of frankness, in which connexion he mentioned the deep impression he had received 'when the representatives of all the countries which had experienced inflation and currency devaluation rose one after another to declare that such experience had been so great a misfortune that it was inconceivable that their respective Governments could again deliberately impose it upon their peoples'. Even those whose general tone was gloomier qualified their pessimism. The Dutch Prime Minister saw no reason for congratulating themselves on the results obtained, though he thought that there was more agreement on commercial policy than had hitherto been the case. Monsieur Colijn, however, undoubtedly expressed a general anxiety when he warned the delegates that countries which, in anticipation of the World Economic Conference, had hesitated in choosing which way to turn in their economic relations with the rest of the world might now awake to a feeling of despair and go in for an exaggerated national economy, thereby arousing other countries to retaliation. Most of the speakers were content to describe the course of events, notably the failure to secure

exchange stability, without seeking deeper causes of disappointment. If there was a general implication in these narratives, it was the proposition that until national policies were more settled and less self-regarding, international effort was bound to be extremely difficult. This philosophy was hotly opposed by Mr. Cordell Hull. There was no logic in the theory, he protested, that domestic policies designed to restore an economic balance were irreconcilable with international co-operation. 'Each country should invoke every emergency method that would increase commodity prices, so that they [*sic*] may gradually be co-ordinated with international action for the common purpose of business recovery.' Dr. Schacht, the President of the Reichsbank, stressed the same point even more emphatically. 'So long', he said, 'as the individual nations have not themselves restored a certain economic equilibrium, the success of another world economic conference will remain doubtful. International co-operation cannot become a practical reality unless countries stop relying upon the help of others and start to do their utmost to master the economic crisis by their own endeavours.'

Was this diagnosis sounder than the popular presumption that the Conference failed simply because agreement could not be secured upon currency stability? By world public opinion, certainly, the United States was made the scapegoat, and not without reason. The nimble inconsistency of her publicly declared policy is easily proved. On the 16th May, in an open message to the other participating states, Mr. Roosevelt placed the stabilization of currencies first among the objects of the Conference. On the 3rd July he rejected a declaration on currency stability (drawn up with the assistance of his own emissaries, and based on a resolution introduced by a member of the American delegation); and in so doing he denounced the efforts to 'divert' the Conference 'from its larger purposes' to 'temporary exchange fixing'. In judging this turning of the presidential coat a European observer must not think in terms of European conditions, but must remember that a President of the United States might attain his tremendously powerful office without ever having held a post of national responsibility before. Mr. Roosevelt,

indeed, was well trained in public affairs; but he arrived at the White House with no experience in such questions as external trade or monetary standards, and presumably with no settled body of principles for dealing with them. Small wonder that he tended to follow the finger of changing circumstances, privy counsel, and popular emotion. To these guides he added his own rooted opinions, which included—for no light reasons in that period of American financial history—a vigorous dislike of bankers and monetary magnates. He suspected the policies that they urged, and he would not choose his economic advisers from among them. The natural radicalism of his mind caused him to listen more readily to those who taught that a cheaper dollar must mean higher internal prices, and who whispered that plans for stabilization were only a European gambit to secure American gold, than to those who praised the economic security of stable exchanges and appealed to the more old-fashioned principles of economics.

However, it profits little to investigate the reasons for presidential policy. The important fact is that it changed, and that the change was the immediate cause of the break-up of the Conference. Yet the inquiry cannot end there. In its amended form, American policy on the exchange issue was far from unjustifiable. It differed in no essential particular from that to which Great Britain had publicly adhered for nearly two years. It was no more stubborn, or more ruinous to the cause of international economic co-operation, than the opposite doctrine maintained by France and other gold standard countries. Even if some compromise had averted the clash between these opposing views on currency stabilization, there is no convincing evidence that the Conference would have achieved any substantial success.

VII

THE AMERICAN CRISIS, 1933–4

SO strong was the creditor position that the United States had built up since the World War, so ample her monetary reserves, that she could withstand without even a rumoured threat to her solvency the international financial strains to which every country was subjected after the Credit-Anstalt crisis. True, the volume of her overseas trade had fallen steeply since the first onslaught of the slump—far more than that of Great Britain, for instance. Between 1929 and 1932 the merchandise imports of the United States fell from \$4,399 millions to \$1,323 millions, while her merchandise exports fell from \$5,241 millions to \$1,612 millions. Nevertheless, by comparison with Great Britain, the ratio of her external trade to the whole national income was small, while her vast capacity for production of all kinds, both primary and manufacturing, gave her a unique opportunity to isolate herself from world forces, even from those which she herself had been the principal means of setting in motion.

For these reasons, among others, financial crisis was delayed in the United States; yet it could not be for ever averted. The slump had exposed and aggravated the notorious weakness of her internal banking structure. Moreover, the depression had been far deeper in the United States, certainly than in Great Britain, and probably deeper than in any other industrial country. Unemployment, for instance, reached a total of 14 millions (according to the estimates of the American Federation of Labor), which would indicate a percentage of unemployment nearly twice as high as the maximum experienced in Great Britain. The index of industrial production fell by over 54 per cent. from the peak in September 1929 to the trough in July 1932. Factory employment, in the same interval, fell by 46 per cent.; what is still more significant, the aggregate pay-roll of factory employees fell by 64 per cent. In other words, the wage-bill of the factories included in the return was little over one-third of what it had been three years previously.

A large part of the population of the United States, moreover, was excessively in debt, either to the banks or to mortgagees or to sellers on the time-payment (or 'hire-purchase') system. When the slump came, thousands of investors in securities had their capital completely wiped out. Agricultural mortgages presented the most striking problem; for the farmer had to bear the brunt of the fall of prices, and he was exceptionally powerful in politics. The insolvency of mortgagors, and the tremendous decline in capital values, even of what had been regarded as the best securities, shook the credit structure down to its foundations. Had the assets of the United States banking system as a whole been valued at their market worth at the beginning of 1933, it is doubtful whether all the capital and reserves of the banks would have been sufficient to make up the aggregate deficit thus established in the balance-sheets. Of course, if there were a sufficient margin of liquidity, such potential insolvency might continue for years without disaster, but only an exceptional demand for cash was needed in order to expose it.

Such a run on the currency reserves would probably have taken place sooner or later, in default of a big industrial revival, as the general public got wind of the banking weakness. Rumour persistently assailed the repute even of the strongest institutions. It was an act of government that crystallized the public distrust. Congress, suspicious of the secret use of public moneys, ordered the publication in detail of the loans made to banks by the Reconstruction Finance Corporation. The revelation that a number of large and respected banks had been compelled to seek recourse to these credits was a shock to public opinion. Among the banks whose difficulties, thus unveiled, caused the greatest perturbation was the Union Guardian Trust Company, of Detroit. In the summer of 1932, this bank, whose resources totalled about $60 millions, had been advanced a total of $16,150,000 by the Reconstruction Finance Corporation, of which $9,475,839 was still outstanding on the 6th January 1933. That such a state of affairs, not critical in itself, should exist in Detroit was an extremely ominous fact; for Detroit was renowned for its local patriotism and sense of tradition, in which sound finance had played an

important part. The public began to transfer deposits from the Union Guardian Trust Company and its banking connexions to other banks. What was still more important, the actual hoarding of currency began to increase throughout the country. By the second week in February the affairs of the Union Guardian Trust Company reached a stage of crisis. There were particular reasons why this bank should not be allowed to close in bankruptcy. The extent to which the Reconstruction Finance Corporation would be involved in the failure was publicly known. A severe blow would be struck at confidence in the banking system in Detroit, throughout the State and even elsewhere. The Trust Company was controlled by a holding concern which also controlled a number of other banks and trust companies in Michigan, all of which might presumably be implicated.

Taking advantage of the public holiday to celebrate Lincoln's birthday, on Monday, the 13th February, the Governor of Michigan, Mr. William Comstock, held a long consultation with local bankers, representatives of the Reconstruction Finance Corporation and of the State Banking Commission, the Deputy Governor of the Federal Reserve Bank of Chicago, the United States Secretary of Commerce, the Under-Secretary of the Treasury, and others. As the presence of these notabilities showed, it was recognized that the decision to be taken was of vital moment for the whole country. Early on the 14th February the Governor declared an eight-day bank holiday throughout the State of Michigan.

The suspension of banking business was not, in fact, complete. The arrangements that were made for partial withdrawals of deposits were, however, used only to a slight extent, indicating that the public, perhaps reassured by decisive governmental action, had not altogether lost faith in the banking system of the State. On the other hand, deposits continued to drain away from banks in various parts of the country. Money was also moving out of the United States, forcing down the value of the dollar. In London the Exchange Equalization Account had to buy dollars in order to prevent an undue rise in sterling, and on the 17th February alone the Bank of England bought nearly £4 millions of gold. Between the 1st and the

27th February the total of money in circulation rose by very nearly $700 millions. Over the same period of less than four weeks, the excess reserves of the Federal Reserve banks, above their bare legal requirements, fell from $1,476 millions to $1,078 millions.

Although the Federal Reserve System as a whole still had an ample margin on which to draw, the pressure on individual banks, inside and outside the system, rapidly became intolerable. On the night of the 24th February a three days' bank holiday was declared in Maryland. The effect, not unnaturally, was to increase apprehension elsewhere and to accelerate the demand for currency. A number of States, including New York, New Jersey, Michigan, Indiana, and Wisconsin, enacted legislation giving State banking commissioners power to restrict withdrawals from banks. On the 25th February the Federal authorities began to take a hand. Congress passed an amendment to the National Bank Act, authorizing the Controller of the Currency, with the approval of the Secretary of the Treasury, to extend the same privileges to national banks in difficulties as State banks were accorded at times of emergency. Within the next few days there was another crop of bank holidays, particularly in the South. The Governor of Kentucky was compelled, for want of any other constitutional means of suspending banking business, to declare 'Days of Thanksgiving', presumably for small mercies. The great banks of New York were being subjected to heavy withdrawals to meet the needs of the banks in the interior. On the 27th February two more large States, Pennsylvania and Ohio, were added to the list of those permitting restrictions on the withdrawal of bank deposits.

On the evening of the 2nd March President-elect Roosevelt arrived in Washington. Already there was talk of a national moratorium, though the outgoing Administration would naturally be reluctant to assume such a responsibility. Eleven States (Alabama, Arizona, California, Kentucky, Louisiana, Maryland, Michigan, Nevada, Oklahoma, Oregon, and Tennessee) had already declared bank holidays. The New York situation was causing particular anxiety. During the first three weeks of February, New York banks supplied to banks in

other parts of the country nearly \$500 millions in cash by drawing upon their excess reserves and by selling bills. The banks in New York City that were members of the Federal Reserve system lost \$444 millions in deposits in the week ended the 1st March. The Federal Reserve Bank of New York, which on the 16th February had tried to ease the situation by lowering its buying rate for 90-day bills to ½ per cent., was forced to raise the rate progressively to 3¼ per cent. on the 3rd March. The rediscount rate (corresponding to London bank rate) was raised from 2½ to 3½ per cent. on the 2nd March. The loss of gold from bank and Treasury reserves amounted in a week to \$226 millions (over £45 millions at par), including an estimated total of \$11 millions for internal hoarding.

On the 3rd March it was announced that Mr. Roosevelt had decided to summon Congress immediately. On the previous evening his Secretary-designate of the Treasury, Mr. William Woodin, had held a conference in New York with a number of leading bankers. The situation was hourly growing more desperate. On the 3rd March alone, \$109 millions of gold was placed under earmark in New York, and bank holidays were declared in Georgia, Idaho, New Mexico, Texas, Utah, Washington, Wyoming, and the District of Columbia. Early on the 4th March, the day of the presidential inauguration, the climax of the banking crisis was reached with the declaration of bank holidays in the States of New York and Illinois. Before the day was out every State in the Union was wholly or partly under banking restrictions.

Franklin Roosevelt took the oath of office as President of the United States shortly after one o'clock that afternoon. Never had a new President been confronted with so momentous a crisis or so tremendous an opportunity. His inaugural speech was terse and blunt. 'Only the foolish optimist', he declared, 'can deny the dark realities of the moment.' There must be an end, he said, to the conduct in banking and business that had too often given to 'a sacred trust the likeness of callous and selfish wrong-doing'. There must be definite efforts to raise the values of agricultural products; strict supervision of all banking and credit investments; an end to speculation with

other people's money; and provision for an adequate but sound currency. 'Our international trade relations,' said Mr. Roosevelt, 'though vastly important, are, in point of time and necessity, secondary to the establishment of sound national economy. I favour as a practical policy the putting of first things first.'

Considering its magnitude, the American banking crisis caused surprisingly little dislocation in the financial markets of the world. Foreign exchange dealings were suspended on the 4th March in London and the other international bourses, but even on Monday the 6th it was possible to reopen dealings in all currencies but United States dollars. In spite of the closeness of their connexion with United States markets, the Canadian banks were unshaken by the crisis—indeed, their position had been rendered even more liquid than before by the influx of American funds during the panic period.

The President acted swiftly. Immediately after the inaugural ceremonies he proceeded to summon Congress for a special session on Thursday, the 9th March. Late on Sunday, after consultation with bankers, business men and Congressional leaders, he issued a proclamation establishing a four days' bank holiday throughout the United States. During the holiday no bank might 'pay out, export, earmark, or permit withdrawal or transfer in any manner or by any device whatsoever, of any gold or silver coin or bullion or currency or take any other action which might facilitate the hoarding thereof'. Nor might it transact any banking business at all, save with the permission of the Secretary of the Treasury, who was empowered to make arrangements for the issue of clearing-house certificates. By a further proclamation on the 9th March, the bank holiday was continued for an indefinite period. The Secretary of the Treasury issued a series of regulations progressively relaxing the ban on banking business, in favour of urgent transactions, and practically no clearing-house certificates needed to be issued.

When Congress met on the 9th March it received a message from the President asking for 'the immediate enactment of legislation giving to the executive branch of the Government control over banks for the protection of depositors; authority

forthwith to open such banks as have been already ascertained to be in sound condition and other such banks as rapidly as possible; and authority to reorganize and reopen such banks as may be found to require reorganization to put them on a sound basis'. Mr. Roosevelt also asked for 'amendments to the Federal Reserve Act to provide for such additional currency, adequately secured, as may become necessary to meet all demands for currency . . . without increasing the unsecured indebtedness of the Government of the United States'.

The same day, Congress passed the legislation desired by the President, unanimously in the House of Representatives, and against seven contrary votes in the Senate. The Act, though intended, according to its preamble, to meet an emergency, was really permanent in its effect. Among its more striking provisions were the following:

1. During a national emergency, the President should be authorized to investigate, regulate or prohibit any transactions in foreign exchange, transfers of credit between or payments by banking institutions, and the export, hoarding, melting or ear-marking of gold or silver coin or bullion or currency.
2. Whenever in the judgement of the Secretary of the Treasury such action should be necessary to protect the currency system of the United States, he might require under penalty the delivery to the Treasury of all gold coin, gold bullion or gold certificates.

In a statement to the Press on the 11th March, and in a radio broadcast on the following day, the President explained his plans for the termination of the bank holiday. On Monday, the 13th March, banks in the twelve Federal Reserve cities would be opened under governmental licence. Similarly, sound banks in 250 cities possessing recognized clearing-house associations would be given licences to reopen on Tuesday, and sound banks elsewhere would be authorized to open on Wednesday or later. Banks which were not members of the Federal Reserve system could and would receive assistance from member banks and from the Reconstruction Finance Corporation. Where any bank could not reopen without

being reorganized the Government had been enabled to assist in making the reorganization quickly and effectively.

These plans were smoothly carried into practice. By Wednesday, the 15th March, most of the banks in the country had resumed business. They were still barred, however, from entering into foreign exchange transactions, except those undertaken for legitimate and normal business requirements, for reasonable travelling and other personal expenses, or for the fulfilment of contracts entered into before the 6th March. Nor were any banks allowed to pay out gold or gold certificates. A considerable number of unsound banks had been refused licences. Out of 6,694 member banks of the Federal Reserve system, 1,307 had not received licences by the 29th March, but their deposits represented less than 10 per cent. of the total. Over one-third of the frozen deposits were in the Federal Reserve District of Chicago, which included the City of Detroit. Nine months after the Michigan bank holiday, the two largest banks affected by the Detroit crisis had not reopened.

As far as the reopened banks were concerned, no abnormal difficulties were encountered. Indeed, money had begun to flow back into the banks long before the holiday period ended. Between the 4th and the 15th March the total of money in circulation had fallen by $216 millions, and the total of gold in circulation (including gold certificates) by $370 millions. Only $10 millions of currency had to be issued under the emergency provisions. When the New York stock exchange reopened on the 15th March, the market was extremely buoyant, making up, on the average, the whole of the losses suffered since the beginning of February.

Technically, the United States was already off the gold standard, since the unlimited purchase and the free export of gold had both been suspended, but the world did not generally expect at that time a practical abandonment in the shape of a large depreciation of the dollar against gold currencies. In fact, when dealings in the dollar were resumed in London on the 13th March, the net result of the banking crisis was seen to have been an appreciation of United States currency against sterling, as the following table shows:

London on:	*Par*	*13th Feb.*	*3rd Mar.*	*13th Mar.*
New York ($ to £)	4·86⅔	3·43¼	3·45¼	3·42
Montreal ($ to £)	4·86⅔	4·12¼	4·08¼	4·14¾
Paris (fr. to £)	124·21	87⅞	87 7/16	87 5/16

Exports of gold under earmark for foreign Governments or central banks, or for the Bank for International Settlements, were allowed, and it was widely expected in financial circles that the United States would shortly return to the full gold standard.

On the 19th April, however, in exercise of his powers under the emergency banking legislation, the President issued a proclamation declaring that a national emergency continued to exist, wherefore the earmarking of gold for foreign account and the export of gold coin, gold bullion, or gold certificates from the United States would be prohibited. The Secretary of the Treasury might issue licences for the export of gold only if it were (*a*) earmarked already or held in trust for a recognized foreign Government or foreign central bank or the Bank for International Settlements, (*b*) imported for re-export, or (*c*) required for the fulfilment of prior contracts or—subject to the approval of the President—for transactions deemed necessary to promote the public interest. The Secretary of the Treasury was given power to investigate, regulate, or prohibit all foreign exchange transactions. Needless to say, this announcement caused a severe slump in the dollar.

	15th Apr.	*18th Apr.*	*19th Apr.*	*20th Apr.*
$ to £	3·44⅝	3·46 11/16	3·56	3·81½

Mr. Roosevelt's hand had certainly not been forced by pressing economic circumstances akin to those which drove Great Britain off the gold standard in 1931. Had there been any persistent overvaluation of the dollar in international trade, it would presumably have been soon reflected in a rise in the relative value of sterling and of other currencies already off gold. The dollar did indeed depreciate by 5 per cent. against sterling between November 1932 and March 1933, but in the latter month it was still 9 per cent. above its sterling value twelve months previously. In the first four months of 1933 the export balance of trade of the United States was

actually higher than in the corresponding period of 1932. The balance of her international payments in that year had given her a net credit of $131 millions on all current items, which was partly liquidated by a gain of $91 millions in gold and currency. The movements of long-term capital showed a net inward balance of $217 millions, whereas in the short-term capital market there was a net outward movement of $371 millions. By the beginning of 1933, in fact, the United States had largely liquidated her previous short-term debtor position. At that date the short-term debt of foreigners to the United States exceeded by $145 millions the short-term debt of the United States to foreigners.

Thus the United States was not exposed to a sudden outflow of foreign short-term funds which would seriously have depleted her gold reserves. These amounted, at the end of March, to $4,282 millions (£880 millions). As for the danger of a flight of American capital, it was a contingency always to be reckoned with, but it had not assumed menacing proportions in the month following the end of the bank holiday, and such as there was had been generated largely by the very belief that the gold standard would soon be deserted. Nor was the United States forced off gold because her relative price level was too high. On the contrary, she went off because her internal price level was too low. The wretched return received by primary producers, many of whom had heavily over-borrowed, was the crying political problem of the day. In Congress, inflationism had plainly begun to threaten the more conservative intentions of the Administration. Congress, particularly the Senate with its dominant representation of primary producers, was in a mood for inflation. The farmers demanded higher prices and debt relief; the silver interests demanded the free coinage of silver; the 'sound-money' men were suspect as tools of the financial powers that the nation had grown to distrust and hate; the state of unemployment cried aloud for massive expenditures of public money, whether upon relief or upon works, and, as no one was prepared for higher taxation, large-scale government borrowing was the only possible means of finance. The United States, in short, deliberately abandoned the gold standard because,

in the judgement of the Administration, to maintain it might have interfered with their plans for raising American prices.

Mr. Roosevelt's first acts as President had been unmistakably deflationary. The Emergency Bank Act, it is true, contained provision for the issue of notes on exceptionally easy terms; but that was intended merely to tide over a panic period, whereas the 'sound-money' provision that only unquestionably strong banks should be allowed to reopen had a profound and enduring effect in limiting the credit base. His budget message, strategically delivered before Congress had got its wind after the banking crisis, was even more conspicuously deflationary; he cut the veterans' bonuses—previously regarded as almost sacred—by about one-quarter, reduced the salaries of Congressmen and Federal employees, and by other adjustments of revenue and expenditure set out to balance the ordinary budget. The contemporary repeal of the Volstead Act and the resultant taxation of beer, pending the repeal of the Eighteenth Amendment, sugared the pill for Congress.

Nor did the President's deflationary measures stop there. His later attempts to assist agriculture, by the reduction of mortgage debts and the restriction of supply, sought rather to achieve adjustment to a diminished volume of purchasing power than to expand the latter to its former amount. Although the economic philosophy of the National Industrial Recovery Act was confused, and although many quasi-inflationists, distracted by its offer of higher prices, lent it their support, many of its provisions were primarily deflationary in character. Its aim was not to raise purchasing power in relation to costs, but on the contrary to inflate costs on the principle that costs become purchasing power at the second remove.

Mr. Roosevelt, however, was not the slave of any rigid programme or apparatus of economic ideas. The Farm Bill began as an attempt to secure adjustment to conditions of deflation. It ended as a sweeping mandate for inflation. Partly, the metamorphosis was the result of Congressional pressure, to which the Administration perforce acceded. On the 13th April, against the wishes of the White House, the Senate adopted an amendment guaranteeing to farmers a

price for their output no less than their costs of production. The inflationist temper of Congress, thus exemplified, began to frighten the financiers and to cause a drain of gold. On the 18th April Mr. Roosevelt felt himself compelled to accept an amendment, associated with the name of Senator Thomas, granting wide powers of monetary inflation. Once he had done so, he probably could not have avoided eventually suspending the gold standard. Yet whatever the political compromises may have been, it seems unlikely that their outcome was specially repugnant to the President, or that they did more than make up his mind for him. As early as the 21st March he had sent to Congress his Civil Conservation Corps Bill, designed to maintain 250,000 or more men at work on the national forests, at great expenditure of public money; he also requested an appropriation of $500 millions for direct unemployment relief, to be distributed through the States by a Federal Relief Administrator. These augmentations of public spending were prime movers of inflation. The balancing of the Budget had fallen into its place as a demonstration to the nervous and a rebuff to vested interests.

The Farm Bill, as it eventually emerged with the Thomas amendment attached, was both startling and compendious. It consolidated under a single authority all the multifarious existing agencies for the distribution of Federal credit to farmers. It provided machinery for reducing farm mortgages and exchanging them into indirect government loans at 4 per cent. (Similar relief was given in another measure to those who had mortgaged their homes.) The Farm Bill also authorized the Secretary of Agriculture to bring about a restriction of primary production by a variety of means; the principle was that the farmer would be given a bounty in proportion to his cuts in acreage, payable out of the yield of a processing tax (i.e. a tax on the manufacture of the commodity in question). The Bill gave the President power to reduce the gold content of the dollar by 50 per cent. or any less proportion. It authorized him to open the mints to the unlimited coinage of silver, and to fix the ratio between silver and gold. In furtherance of this purpose, he might in the course of one year accept up to $200 millions in silver on account of war debt payments, at

a rate of not more than 50 cents an ounce. He was given power to sell up to $3,000 millions in American Government securities to the Federal Reserve system, and to issue up to $3,000 millions in paper currency ('greenbacks') for the redemption of outstanding Federal obligations, on condition that the notes were retired at the rate of 4 per cent. per annum.

The National Industrial Recovery Act was even more heterogeneous both in content and in inspiration. Three main motives animated its construction. First, certain leaders of 'big business' had adopted the idea of industrial 'planning' as a means of combating the evils of unrestricted competition; they were baffled, however, by public fears of exploitation, which had found their most striking expression in the anti-trust Acts of 1890 and 1914. Secondly, social workers and leaders of progressive opinion recognized the disastrous effects of chaotic competition upon those employed in industry. In the United States factory legislation lagged far behind the accepted standard in Great Britain; and the need of it became all the more acute during the depression, when the weakest were forced to the wall. Thirdly, organized labour had attached itself to the theory that unemployment could best be diminished by spreading the volume of work available among a greater number of people, that is to say, by shortening hours and by taking whole classes of workers, like young children, out of the labour market altogether. Political opinion did not immediately perceive how these ideas inevitably conflicted with each other.

Title I of the resultant Act was based on a declaration that there existed a national emergency. Any association genuinely representative of a trade or industry might draw up a code of fair competition. The code would not become effective until it had secured the approval of the President, who might amend or amplify it, or grant exemptions. Once approved, it would assume the character of law, violations being punishable by fines. Recalcitrant industries might have codes imposed upon them. Every code must establish the right of the employees to collective bargaining and to trade-union membership. It must prescribe maximum hours, minimum wages, and other working conditions. The main provisions of the Bill (which

carried exemption from the anti-trust laws) were to remain in force for two years, unless the emergency should previously be declared at an end.

Title II authorized the President to spend $3,300 millions on public works in the broadest sense, including naval construction and slum clearance.[1] While this provision had little direct connexion with the major part of the Act, it was in effect the essential counterpart of the code system. Without the augmentation of purchasing power implied in the public works programme, N.R.A. might have fatally dislocated industry, and, by raising costs faster than demand, have diminished the volume of employment and even forced down the prices of primary products.

The third major piece of legislation in this period was the Glass-Steagall Banking Act. Its main purposes were to extend the system of branch banking, to initiate the co-operative insurance of bank deposits, and to check such speculative and corrupt practices as had been unearthed by the Senate Committee's current investigation into banking operations. Member banks of the Federal Reserve system, together with private banks, were forbidden to combine security business with the acceptance of deposits.

Among the other measures of international interest passed before the summer recess were the Securities Act, imposing heavy personal penalties on individuals or officers of corporations who should misrepresent facts in connexion with the public flotation of securities; an Act setting up Federal employment exchanges; and a resolution annulling the 'gold clause' in both public and private contracts.

All this time the general economic condition of the United States was unquestionably improving. Commodity prices reached their nadir in February 1933; the most conspicuous advance thereafter was achieved by the prices of farm products, which rose from an average of 40·9 in February (1926 = 100) to 60·1 in July. The index of industrial production,[2]

[1] This was not by any means all new money. Approximately $1,000 millions had already been allocated by Congress, much of it under the regular Federal Budget, from which it was transferred.

[2] The indices of production and employment are adjusted for seasonal variations.

after falling to 60 in April (1923–5 = 100), rose to 100 in July. The index of factory employment (on the same base) rose from 57 in March to 70 in July, while factory pay-rolls increased from 37 per cent. of the 1923–5 level to 50 per cent. It would be hard to account for this activity without acknowledging the great influence of speculative forces. Little new money was coming into circulation. Construction contracts awarded from February to July of 1933 were nearly 40 per cent. less than in the same period of 1932. During these six months the contracts awarded for public works and public utilities were actually 60 per cent. below the 1932 figures. New capital issues were smaller than ever. Recovery, both of trade and of prices, was being caused by being presumed. Meanwhile the mere depreciation of the dollar had a stimulating effect on certain local prices, principally those of commodities, like wheat, whose price was fixed on a world market. By the middle of July, the dollar had fallen from its parity of 3·918 cents to one franc to 5·70 cents—a drop of over 30 per cent.

By October industrial production had fallen back to 77 per cent. of the 1923–5 average, and the index of commodity prices, which had risen from 60 in April to 69 in July, stood no higher than 71 three months later. The prices of farm products had actually fallen by 7½ per cent. of their July figure. A somewhat better balance, however, had been achieved between consumption goods industries and capital goods industries. The total of constructional contracts awarded rose from $82,700,000 in July to $145,400,000 in October—public works and public utilities being wholly responsible for the rise. Moreover, thanks to the spreading of work enforced by the N.R.A., factory employment did not fall in accordance with the drop in industrial production.

The reaction from the minor inflation of the summer and the continued low prices for agricultural products naturally excited fresh discontent. Its most troublesome expression was the farmers' strike movement, a rather incoherent demonstration against low prices and high mortgages. The farmers, divided on detailed policy, demanded one common specific—inflation. Congress itself was returning to the inflationary

mood of the days when it was debating the Farm Bill. Bankers and industrialists, on the other hand, demanded a period of stability and security in which 'natural' recovery could proceed without interference from the Government. The idea of a 'managed currency' and a 'commodity dollar' was a middle path between the green-back inflationism of the West and the economic conservatism of the East.

The burden of Mr. Roosevelt's broadcast speech on the 22nd October, delivered at the height of the farmers' strike, was the need for raising prices. 'If we cannot do it one way', he said, 'we will do it another. Do it we will.' The way they would pursue for the moment was to 'control the gold value of the dollar at home', out of range of 'the accidents of international trade, the internal policies of other nations, and political disturbance in other continents'. The Reconstruction Finance Corporation would be authorized to buy gold newly mined in the United States, and also, wherever necessary to the end in view, gold on the world markets, at prices to be determined from time to time after consultation with the Secretary of the Treasury and the President. This was not an expedient, added Mr. Roosevelt, but a policy, designed to 'establish and maintain a dollar which will not change its purchasing power during the succeeding generation'.

The theory behind this scheme was dubiously founded. Within limits, certainly, a free exchange rate would represent the ratio between the price level at home and price levels abroad (the 'purchasing power parity' theory). Hence, it might have been deduced that by depressing the exchange rate—that is, by raising the price of gold—home prices would be correspondingly raised. But obviously this would be true only if foreign prices remained stationary. Moreover, the purchasing power parity theory essentially applied to a free exchange; it did not rule out the possibility that the exchanges might be artificially pegged at a level different from the 'natural' parity. Nevertheless, unless and until external prices fell as far as the gold value of the dollar, a rise of certain American prices was to be expected from a deliberate increase in the price of gold. Imported commodities would command a higher price; so would home-produced goods whose price

was fixed on a world market (provided the dominating source of supply was not the United States itself). But it was also certain that, in the absence of internal inflationary forces, the rise of American prices would not be so rapid or so widespread as to counteract completely the fall in the exchange value of the dollar. Hence, imports would be somewhat checked and exports stimulated, and gold would tend to flow in.

These theoretical expectations were by no means falsified by events. The price announced for purchases of gold by the Reconstruction Finance Corporation, on the 25th October was \$31·36 per fine ounce, \$1·50 more than the market price[1] on the previous day. At first, however, purchases were confined to newly mined American gold. The picture changed when, on the 29th October, the American Government announced their intention of buying foreign gold. The price then fixed was \$31·96, equivalent to a sterling price of 133*s.* 5*d.* per ounce, which was 1*s.* 9*d.* above the contemporary London quotation. The rate of exchange on London promptly moved from \$4·70 to \$4·78¾.[2] Though the R.F.C. buying price was raised daily by small steps, comparatively little foreign gold was bought, for two connected reasons. First, the market was not an open one, there being no undertaking that the Corporation would buy any gold at all; hence arbitrage operations were out of the question. Secondly, after an initial period of hesitation, short-term funds moved out of the United States in the expectation of further advances in the gold price, and the exchange value of the dollar was thus driven down faster than the gold price was raised. On the 6th November a milestone of monetary history was passed when the pound appreciated against the dollar beyond its former parity of \$4·86⅔. The extreme rate on that day was substantially higher than any that had been recorded since August 1914. The gold price had by then been raised to \$32·84. At this figure, a brief halt was called in the raising of the price, and there were rumours of impending stabilization.

[1] On the 29th Aug. the President had authorized the Treasury to receive on consignment for sale gold newly mined in the United States, thus enabling American mines to take advantage of the world price, as expressed in dollars. Thenceforward the market price for gold in the United States was based on the dollar-franc exchange.

[2] Mean prices on the 28th and 30th Oct.

Two days later, however, the price was advanced again, and the dollar continued its downward course. The Bank of France began to suffer a considerable loss of gold, not directly to the United States, for the most part, but to London and other centres, to be held in anticipation of a further improvement in the price of gold. The result was a depreciation of the pound against the franc, though it always lagged behind the fall of the dollar. The Chancellor of the Exchequer stated on the 9th November, in answer to suggestions that the pound was being tied to the dollar, that the general policy of the Government was to maintain the independence of sterling.

On the 15th November the dollar fell to a low record of \$5·50 to the pound, largely by reason of speculative movements. At that point, however, many bears of the dollar began to liquidate their commitments, believing that in future the depreciation against gold would not be so spiritedly pursued. At a level of \$33·56 per ounce, in fact, the authorities had again paused in their policy of pushing up the gold price. The exchanges consequently reacted sharply in America's favour. Meanwhile, several untoward events had occurred in the United States itself. The first effects of the gold-buying policy were quite satisfactory to the Administration. Commodity and stock markets were optimistic, the prices of primary products rose, and the farmers' strike petered out. Later developments, however, were more disconcerting. The rise of prices did not keep pace with the depreciation of the dollar. Wide schism appeared among the President's own advisers. Mr. Dean Acheson, the Under-Secretary of the Treasury, who was generally described as a 'sound money man', was jettisoned from the Administration. On the 21st November Dr. Sprague, formerly economic adviser to the Bank of England, from which post he had been summoned by Mr. Roosevelt to become special assistant to the Treasury, announced his resignation as a protest against the monetary policies being pursued. The vast governmental expenditures, he said, threatened uncontrolled currency inflation. The mere external depreciation of the currency would not bring about a speedy general rise of prices, which could only result from an

increased demand for materials and labour. This protest was met by vehement retorts from Mr. Woodin, Professor Rogers, Professor Irving Fisher, and others.

Whereas during the period when capital was flowing out of the United States on a large scale in order to profit by the depreciation of the dollar the exchanges moved faster than official price of gold, after the reaction in mid-November the the position was reversed. The market value of the dollar in London was sometimes 30 cents in the pound higher than the current gold parity. Changes in the gold price, indeed, almost ceased to affect either the exchanges or the commodity and stock markets. These anomalies, of course, could not have occurred had the Reconstruction Finance Corporation offered an open market for gold, or had its purchases of foreign gold been on a scale sufficient to keep the exchanges in check. On the 8th January the Chairman of the Corporation announced that gold purchases on behalf of the Government had totalled about $20 millions of domestic gold and $55 millions of foreign gold. Purchases were then accelerated, no doubt in order to resume control over the exchanges, and during the remaining week in which the R.F.C. continued to be the agent for American official gold buying it acquired a further $50 millions or so abroad.

In a message to Congress on the 15th January 1934, the President asked for legislation to vest in the Federal Treasurer the title of all monetary gold in the United States. It would be taken over at the former parity, so that the book profits arising from revaluation at a higher rate would accrue to the Treasury. The President asked Congress to set an upper limit of 60 cents gold for the new value of the dollar, which he already possessed authority to reduce to a lower limit of 50 cents. Because of 'world uncertainties', he thought it undesirable to fix a precise value at that time. Powers were requested for the Secretary of the Treasury to deal in other currencies in order to 'bring some greater degree of stability to the foreign exchanges'. To this end the President proposed that 'out of the profits of any devaluation there should be set up a fund of $2,000 millions for such purchases and sales of gold, foreign exchange and government securities as regulation of the

currency, maintenance of the credit of the Government, and the general welfare of the United States may require'.

On the same day Mr. Morgenthau, who had succeeded Mr. Woodin as Secretary of the Treasury, announced that until further notice the domestic price for gold would be \$34·45 per fine ounce, equivalent to a 60 cent dollar. American prices generally underwent a sharp speculative advance. The immediate effects of the new decision on the exchanges, however, were the reverse of what might have been expected. The dollar appreciated. On the basis of a dollar at 60 cents gold, the London–New York rate should have been about \$5·23 on the 16th January, whereas actually it moved from \$5·15 to \$5·08¾. On the following day the rate touched \$4·95. There was no apparent explanation of this movement save a return of funds to the United States, induced by belief that the enforced depreciation had come to an end, and that 60 cents rather than 50 cents was the mark aimed at by the Administration. It was significant, however, that the franc appreciated against the pound, indicating that London money was being invested in currencies with which gold could be freely obtained, in the hope of profitable resale to the United States. The strength of the dollar was obviously displeasing to the Administration, who took steps to undo it by buying gold.

The Gold Bill, ending the circulation of gold coins and gold certificates in the United States, vesting all monetary gold in the Treasury, and setting up the \$2,000 million stabilization fund, received the President's signature on the 30th January. The only real embarrassment for the Administration was an attempt to pass an amendment requiring the Secretary of the Treasury to buy silver until the price had reached a ratio of 1 to 16 to that of gold; the amendment was defeated in the Senate by no more than 45 votes to 43. On the 31st January Mr. Roosevelt issued an announcement fixing the gold content of the dollar at $15\frac{5}{21}$ grains, 9/10ths fine, equivalent to 59·06 cents at the old parity, and to \$35 an ounce for gold. The book profit on the gold reserves was \$2,805,512,060. This revaluation was performed, declared the President, 'in order to stabilize domestic prices and protect foreign commerce against the adverse effect of depreciated foreign

currencies', and also because the emergency required an expansion of credit.

Although the President had announced that the Treasury would buy any and all gold delivered in New York or Seattle at \$35 per fine ounce (less charges for minting and handling), and Mr. Morgenthau had added that gold would be sold for export to central banks when exchange rates reached the gold export point, the financial markets of the world did not immediately realize that the United States was back on the gold standard. There was, in fact, this important difference: no guarantee of any kind was given that the rate of conversion between dollars and gold would not be altered without notice in order to serve internal policies. On the contrary, the presidential proclamation had expressly reserved the right of alteration or modification 'as the interest of the United States might seem to require'.

The opening of a free and unlimited market for gold in the United States drew heavy shipments of gold from Europe and elsewhere. The short-run and the long-run causes of this movement must be distinguished. The most compelling short-term force was the return of capital to the United States. The amount of funds that had fled from the dollar during the previous twelve months cannot be precisely determined, but it certainly amounted to several hundred million dollars, and many exporters of capital only awaited the signal of devaluation to take their profits on re-import. The return of American money was reinforced by a considerable flow of European capital to Wall Street, bent on taking advantage of the speculative opportunities opened up by the new policy.

The principal long-term force at work was the fact that the dollar, at 59 per cent. of its former exchange parity with gold currencies, was unquestionably undervalued. On the basis of American prices it was worth a great deal more. Between the beginning of April 1933 and the initiation of the gold-buying policy, commodity prices in the United States rose by 17 per cent. At the end of January 1934 another 3 per cent. rise had been added. On the generous assumption that the dollar had been 10 per cent. over-valued before the United States went off the gold standard, it was worth in January, on

the basis of purchasing power, not 59 per cent. but 75 per cent. of its former parity. The natural effect of an undervalued currency would be, of course, to create a favourable balance of trade and services, which could be liquidated only in gold.

The combination of these short-run and long-run forces kept the exchange value of the dollar well above its new gold parity, so that arbitrage transactions in gold became extremely profitable. There began a commerce in precious metal that did no credit, in the eyes of the general public, either to the gold standard itself or to those in America who had adopted it on such arbitrary terms. Every westward-bound Atlantic steamer sailed with its strong-room crammed with bullion. Specially chartered aeroplanes flew across the Channel from Paris and Amsterdam with gold for shipment from Southampton or Plymouth. Within a fortnight £45 millions of gold had been dispatched from Europe and India for sale to the United States Treasury.[1] By the end of February the dollar had fallen to approximately its gold import point.

It was openly hinted by Mr. Morgenthau himself that one of the main purposes of the $2,000 million stabilization fund was to combat the British authorities in their supposed use of the Exchange Equalization Account to keep the pound undervalued. The immediate effect, however, of the undervaluation of the dollar was a depreciation of sterling against gold. The profit obtainable on the sale of gold to New York caused money to flow from the pound into the franc and other currencies with which gold could be freely bought at mint rates. Hence, the pound depreciated against the franc and the price of gold in London rose sharply. This movement was checked but not reversed by the fears concerning the future of the franc that were raised by the Paris rioting on the 6th and 7th February 1934. A frantic boom in gold shares in London and Johannesburg was the natural consequence. At the end of three weeks the dollar had fallen by 4 per cent. against gold currencies and by 2 per cent. against sterling; while sterling had

[1] Between 1 Feb. and 9 Mar. purchases of gold by the Treasury totalled $593 millions, mostly from abroad, but including also newly mined American gold.

depreciated by $2\frac{1}{2}$ per cent. against the franc, and the London price of gold had risen by a similar proportion.

Thereafter, financial and commercial markets settled down calmly enough to the new régime of an undervalued dollar. The inevitable failure of American prices as a whole to rise as fast as the dollar had depreciated threatened the world with further deflation; for American competition would be enhanced in outside markets, while a fresh barrier had been erected against imports into the United States. Gold prices of commodities in fact fell by about $1\frac{1}{2}$ per cent. during the subsequent two months. There were, however, some compensating forces. The N.R.A. codes had raised industrial costs in the United States, and the inflation that was in prospect would presumably raise them further. Even more important over a short period was the fact that a great part both of America's exports and of her imports were virtually non-competitive. Moreover, if the Administration's policy were eventually successful in restoring the volume of production in the United States, other countries could not fail to benefit, since the American market for industrial raw materials, and to a less degree for manufactured goods, was one of the principal determinants of world prosperity.

VIII

COMMODITY REGULATION, 1931–5

(a) *The Restriction of Production*

IT will have been noted that the most immediate practical by-product of the World Economic Conference was a series of moves towards the restriction of supply of primary commodities. In an earlier chapter dealing with this matter special attention was given to the rubber, wheat, and tin industries. In the following pages the restriction schemes in those industries again receive detailed consideration, together with the international copper agreement of 1935. But these four were not by any means the only commodities of importance to be subject to restrictions of production or trade. By 1935 international restrictive schemes were actually or nominally in force for wheat, nitrates, rubber, sugar, tea, tin, copper, diamonds, potash; and there were national restrictive schemes of world-wide importance for a number of other products, including oil, cotton, and cereal grains in the United States, coffee in Brazil, and jute in British India. This list takes no account of national schemes for the combined regulation of imports and internal production, like the British agricultural marketing schemes; nor of national and international cartels for regulating the output, sales, and prices of manufactured commodities. The most prominent of these combinations was the European steel cartel, to which Great Britain adhered in the course of 1935. It will be seen that only a very few primary commodities escaped the régime of restriction, the chief exceptions being wool, timber, and lead.[1] This, then, was no merely incidental or subordinate problem in world economics, but one of the most vital facts of the time in international trade, production, and finance.

Wheat.

An International Wheat Conference, held in London in May 1931, failed to reach unanimous conclusions on the

[1] Coal, in this connexion, must be reckoned on a footing more with cartelized manufacturing industries than with the other major raw materials.

matter of market control, largely because the U.S.S.R. refused to consider restriction of production, while other countries saw little advantage in a plan for export quotas unless it were accompanied by some check on the accumulation of large unmarketable surpluses. During the meeting of the World Economic Conference, the principal exporting countries agreed to a limitation of exports (though not of production) in 1933–4 and 1934–5, while the chief importing countries promised not to encourage any extension of the area sown to wheat, to adopt every possible means of increasing wheat consumption, to lower customs duties on wheat when its price showed a substantial improvement—the standard figure being equivalent to 63·02 gold cents per bushel—and to relax quantitative restrictions on the trade in wheat, again on condition that there was a rise in price. A Wheat Advisory Committee was set up to watch over the execution of the agreement.

From the first the Committee was faced with severe difficulties, arising mainly out of the large exportable surplus of Argentina in 1933–4. In April 1934 the Committee unanimously recommended a scheme for minimum export prices. When, however, this was referred to the Governments concerned, Argentina declared herself unable to comply. By June 1934 she had already exceeded her agreed quota of exports (110 million bushels) for the crop year ending on the 1st August. She plainly feared that the fixing of minimum prices would prevent her from marketing her exceptional surplus, since it would rule out any under-cutting of Canadian or American prices.

The carry-over of wheat at the end of the crop year 1933–4 was 1,140 million bushels, 20 million bushels more than at the 31st July 1933, and nearly double the average of 625 million bushels in the period 1922 to 1928. By comparison with the acreage in the basic period accepted in the agreement (1930–1), acreage in 1933–4 had declined by over 5 per cent. in Argentina, over 15 per cent. in Australia, over 10 per cent. in Canada, and over 12 per cent. in the United States. The United States delegation told the Advisory Committee, at its meeting in August 1934, that the prospective crop failure, following a poor crop, had greatly modified the reasons that had led the

American Government to pursue a reduction of acreage; nevertheless, they would take steps to prevent the areas sown from rising above the current level, provided that other countries were ready to continue the general effort to adjust wheat production to demand.

At the August meeting no agreement on new quotas or on restriction of production could be reached, but the Committee accepted, for consideration by the signatory Governments, a series of far-reaching amendments to the international agreement, including its prolongation for a further two years from the 31st July 1935. It was proposed that future quotas, instead of being reckoned as a settled percentage of expected import demand, should be calculated in relation also to estimates of actual production. Argentina, having expanded her acreage since the War of 1914–18 by a far smaller proportion than Canada or the United States, claimed that she was now in a period of natural expansion, rather than contraction. In this claim she had the sympathy of Australia, whose representatives at the World Economic Conference had strongly opposed restriction in principle.

The Advisory Committee met again in Budapest in November 1934, but adjourned without taking a decision on the revised proposals as a whole, Argentina still not having composed her differences with the three other oversea exporters. The meeting was not without fruits, however, for it secured the agreement of the main importing countries, and of Hungary, Bulgaria, and the U.S.S.R., to the prolongation of the agreement for another two years; and it allotted an export quota to France, whose efforts to protect her farmers, combined with a favourable crop, had expanded her output temporarily beyond her own needs.[1] At the end of May 1935 the Committee agreed unanimously to recommend to the Governments an extension of the agreement for a single year, that is to say to the 31st July 1936. The Committee concluded (so ran an official statement) that, notwithstanding two successive crop failures in North America, the maintenance of the existing level of world wheat acreage must, given average yields per acre, result in the reaccumulation of further burdensome supplies.

[1] See below, p. 366.

Nature had indeed come to the aid of Man in reducing stocks of wheat and raising its price. The world's exportable supplies of wheat, which in 1932-3 had amounted to 1,258 million bushels and in 1933-4 to 1,144 million bushels, were expected to be no more than 880 million bushels in 1934-5. These prospects had caused a rise of 25 per cent. in the Liverpool price of wheat in the twelve months ending in May 1935.

In July, however, there was a sharp reaction in wheat prices. The immediate cause was the prospect of legislative changes in Canada which, it was thought, would increase the pressure of Canadian exports on world markets. When the holding policy of the Western wheat pools had collapsed in 1930, the Government had intervened with pledges to save farmers from bankruptcy, and had proceeded with a policy of holding up the Winnipeg wheat price by buying wheat and allowing it to reach the world market only at prices regarded as profitable. Since ample supplies were forthcoming from the rest of the world, particularly from Argentina, large stocks gradually accumulated in the hands of the Canadian Government's agent, Mr. John McFarland. The Conservative Government under Mr. R. B. Bennett, which had supported the operations of Mr. McFarland against the constant criticism of the Liberals, introduced in June 1935 a Bill establishing a national Grain Board with virtually monopolistic powers. The Bill, however, was severely amended by the Select Committee to which it was referred; they struck out the compulsory provisions in order to allow farmers to sell their wheat through the Board or on the open market as they thought fit, and they defined the duty of the Board as being, *inter alia,* to sell existing Government-agency stocks as speedily as might reasonably seem possible, and to offer wheat for sale continuously through the established channels. It was the prospect of heavy sales of Canadian wheat that precipitated the slump of prices in July.

As soon as the weak technical positions had been liquidated, however, the bull points for wheat reasserted themselves, and it was seen that, so far from Canada's being at the mercy of importers, the importers must for the time being take their cue from Canada. The United States, thanks to her poor crop, was temporarily out of the world wheat market. Stocks in the

Southern Hemisphere and in the United Kingdom on the 1st August, together with cargoes afloat to Europe, represented no more than eighteen weeks' supply at the rate at which Australian and Argentine wheat had been absorbed in the previous crop-year. On the 7th September the Canadian Wheat Board, of which Mr. McFarland had been made chairman, fixed the minimum price for payment to farmers at 87½c. per bushel for No. 1 Northern Manitoba, a price well in excess of those that had been obtaining on the open market. Within eleven weeks the price of wheat rose by 34 per cent. in Liverpool and by 19 per cent. in Winnipeg.

Again there was a change in Canadian outlook and policy. On the 23rd October Mr. Mackenzie King replaced Mr. Bennett as Prime Minister of the Dominion. The Wheat Board was placed under the responsibility of a committee of the Dominion Cabinet, and Mr. McFarland resigned his chairmanship of the Board in favour of a Liberal politician, Mr. James R. Murray. These developments naturally caused a certain depression of world wheat prices. Canadian wheat continued to be 'on tap' at market prices, in accordance with Mr. Murray's declared policy of reducing Canada's stocks to 125 million bushels at the end of the crop year.

There is no escaping the conclusion that the International Wheat Agreement had much less effect upon the world's wheat markets than the hand of Nature. In the first two years of its operation its success in its main purpose, to raise the price of wheat, was negligible. Indeed, the average price of wheat in Liverpool was 10 per cent. higher in 1932–3, the year before the wheat agreement went into operation, than in the first year of the agreement's life. In 1934–5 there was a slight improvement over 1932–3, but it was the droughty weather in three continents, not the terms of the agreement itself, that had produced this favourable result. The agreement had made no advance whatever towards its ultimate goal of creating a state of affairs in which European importing countries would be prepared to cut their barriers to trade and increase their imports of wheat. This lay at the heart of the world wheat problem. In 1927–8 the production of the exporting countries had been 2,534 million bushels, and that of the importing countries

1,077 millions, making, with 3 millions of exportable supplies from the U.S.S.R., a total of 3,614 million bushels. Consumption (outside Russia, China, and a few other countries not included in the statistics) totalled 3,546 million bushels. In 1934–5 the consumption figure was 3,577 million bushels—almost exactly the same. But how differently this need was filled: 258 millions came out of stocks; the same small quantity as in 1927 came from the U.S.S.R.; and of the remainder the exporting countries produced 1,966 millions (against 2,534 millions in 1927–8), and the importing countries produced 1,350 millions (against 1,077 millions). Thus world overproduction and low prices were the fault, not of the oversea exporting countries, but of the importing countries of Europe.

Rubber.

As a result of negotiations between Dutch and British producers, in May 1930 the entire rubber plantation industry under European control voluntarily ceased work for a month. This action coincided with a fall in prices to below 7*d.* a lb. Partly owing to the high proportion (nearly one-half) of the industry in the hands of native producers, partly owing to the severity of the depression among rubber-users, the 'holiday' had little visible effect on stocks and less on prices. Other plans were then put forward, including one on the lines of the Stevenson scheme, with 9*d.* as the pivotal price, which secured the support of representative Dutch and British planters; but American producers in Netherlands India were opposed to restriction, and the Netherlands Government refused their support. Early in 1932 the British and Netherlands Governments unsuccessfully engaged in direct negotiations. The negotiators were understood to have studied over forty different schemes submitted to them, but finally to have tripped over the stumbling block of native rubber production in the Netherlands East Indies. In spite of this decisive failure, unofficial and official negotiations took place at various times and places in 1932 and 1933. Representatives of Netherlands and British producers again consulted together in Amsterdam in January 1934. All this time the very low price of rubber favoured the movement of opinion towards restriction. But it was not until

the last day of April 1934 that the success of these negotiations could be announced.

The purpose of the proposed scheme was stated in the agreement to be 'to regulate the production and export of rubber in and from producing countries with the object of reducing existing world stocks to a normal figure and adjusting in an orderly manner supply to demand and maintaining a fair and equitable price level which would be reasonably remunerative to efficient producers'. Although this preamble referred to the control of production, the agreement itself was based upon the restriction of exports, leaving production to the authority of the several Governments invited to endorse the scheme. The signatories, however, included in their requests the prohibition of further planting, except for experimental purposes. Replanting was to be limited during the life of the agreement to the equivalent of 20 per cent. of the existing planted area of any one holding; and the export of planting material from the participating territories was to be prohibited. The countries covered by the scheme were Malaya, the Netherlands East Indies, Ceylon, British India (including Burma), French Indo-China, the State of North Borneo, Sarawak, and Siam. Certain of the smaller producing countries, however, were granted special terms. The scheme provided for a levy on exports in order to finance research into the utilization of rubber.

The basic allowances are shown in the table below:

(In thousands of tons)

	1934	*1935*	*1936*	*1937*	*1938*
Malaya . .	504	538	569	589	602
N.E.I. . .	352	400	443	467	485
Ceylon . .	77½	79	80	81	82½
Other countries[1] .	63	71	76	80	82

One important feature of these allowances was the decline in the ratio of Malayan to Netherlands East Indies quotas. In 1932 the ratio of actual production had been 1·92 to 1. Yet the basic allowances provided for a reduction of the ratio from

[1] India, Burma, North Borneo, Sarawak, Siam.

1·4 to 1 in 1934 to 1·27 to 1 in 1938. The underlying fact was the existence of much greater potential capacity in the Netherlands East Indies than in Malaya, as a result of extensive replanting during the life of the Stevenson restriction scheme. The percentage of the basic tonnages that might be exported was to be determined periodically by an International Rubber Committee, consisting of delegates appointed by the participating Governments. Votes would be cast by delegations, but would be proportionate to the basic tonnages. The agreement was to run for a minimum period of four and a half years from the 1st June 1934 to the 31st December 1938.

The negotiators of this scheme had been faced with a serious position in the rubber industry. At the end of 1928 world stocks of crude rubber had totalled 289,900 tons; by the end of 1933 they had risen to 654,000 tons. Demand had been rising since 1931, and in 1933 was higher even than in 1929, largely because the low price of crude rubber had greatly discouraged the use of the reclaimed product; but production still outstripped demand. The average price of rubber, which had been 35·06*d.* per lb. in 1925, and had fallen to 10·25*d.* in 1929, slumped rapidly after the onset of the world depression, and the average for 1932 was only 2·34*d.* per lb. At one time the London price was less than 2*d.* per lb. The average price in 1933 was slightly higher—3·245*d.*—but it was still unremunerative to the estates, notwithstanding the great and painful economies that had been made since the boom years. The persistence of an uneconomic price (declared the Rubber Growers' Association) was bringing serious social and political consequences in its train. Moreover, if further prolonged, it threatened the long-term interests of consumers, since a dislocated rubber-producing industry could not be relied on to provide in a regular manner the supplies of rubber which the world might need.

The scheme was well received among producers and was accepted by the principal Governments concerned in the course of May 1934. The hardening prospects of restriction had steadily driven up the market price of spot rubber in London, and on 7th May it touched 7¼*d.* The International Rubber Committee, however, disappointed the market with

its initial plans for restriction. It proposed that the quotas for June and July should be 100 per cent., for August and September 90 per cent., for October and November 80 per cent., and for December 70 per cent. These rates would give an exportable allowance of 506,000 tons for all areas in the first seven months of the scheme. Consumption, it was estimated, would be approximately 525,000 tons in that period. The Committee made no attempt to fix a pivotal price, but the moderate rate at which they proposed that stocks should be reduced indicated that they had no immediate ambition to maintain prices at a higher level than 6*d.* to 7*d.* a pound.

Following differences between the Dutch and British producers, the latter of whom favoured a more intense degree of restriction, the International Rubber Committee fixed the export quotas for the first three months of 1935 at 75 per cent. of standard allowances, and those for the second, third, and fourth quarters of the year at 70, 65, and 60 per cent. respectively. The last rate, it was decided in December 1935, would continue for the first six months of 1936. The intensification of restriction had been made necessary by the poor prices that continued to rule through 1935 and by the disappointingly small reduction in world stocks. On the one hand, demand had not come up to expectations; on the other, the difficulties of controlling native output in the Netherlands East Indies had resulted in an excess of exports beyond the quota.

When the scheme first came into effect, direct restriction of production on an individual basis was administratively impossible in the native growing areas. The principal method of control employed by the Dutch authorities was an export-tax on native rubber intended to restrain production by limiting its profitability. The People's Council of the Netherlands East Indies had rejected the proposal for such a tax, but they were overruled by the Government, who fixed the initial rate of duty at 20 cents per kilogram of dry rubber. In December, with lower world prices, the rate was reduced to 16 cents. In 1935, however, excess shipments of native rubber again began to appear, and as world prices rose in the latter part of the year the export duty was raised by successive stages to 29 cents on the 11th December. The price of native rubber in

Batavia being then 40½ cents per kilogram, the duty left the producer only 4½ cents after allowing 7 cents for expenses. Nevertheless, every fresh advance in the world price of rubber stimulated more native production, and when the London price went above 7*d.* a pound in February 1936 the export duty was again raised, this time to 32 cents per kilogram. In the meantime, the Netherlands East Indies Government, in order to correct the excess shipments beyond the quota, had provided approximately £760,000 for the purchase of rubber export licences from estate and native producers.

It had become clear that the Netherlands East Indies Government were fighting a losing battle in seeking to keep native exports within the allotted quota. In December 1935 the International Rubber Committee, therefore, agreed to recommend to the participating Governments an increase in the basic quotas allotted to the Netherlands East Indies. Instead of 443,000 tons, 467,000 tons, and 485,000 tons for the years 1936 to 1938 respectively, they would be increased to 500,000 tons, 520,000 tons, and 540,000 tons. The basic allowances granted to the other participating territories would be unaltered. Thus the ratio of Malayan to Netherlands East Indies allowances was further reduced from 1·27 to 1 in 1938 to 1·11 to 1.

The problem of native rubber production was one of considerable international moment. The native grower, of course, had virtually no production costs expressed in money. Almost his only outlay was the sacrifice of some of his leisure. An extremely low price might even encourage him to tap more rubber in order to make up in quantity what he lost in halfpence per pound, and so to provide himself with the same total sum in cash. The lay public might be excused for asking why, if the natives could produce rubber at 2*d.* or 3*d.* a lb., should the consumer be compelled to pay twice as much or more in order to support a more elaborate means of production. One answer that was given was that the problem of relative costs of production must be judged in relation to the whole output of the industry and to the whole demand for the commodity. The native growers could produce 200,000 tons per annum of rubber, or perhaps more, at a gross cost

of under 4*d.* a pound; but, it was claimed, they were incapable of producing, at any price, four times that amount,[1] which was the quantity of rubber that the world needed. The estate-producers could claim that the industry as a whole ought to be allowed a reasonable internal income and a reasonable rate of return for those who had sunk money in it.

They had a further argument still. It was only by reason of the investment of European capital that the natives were able to produce rubber at all. Rubber was not indigenous to the East Indies; the trees were originally introduced from South America, and the natives, who tapped wild or half-wild rubber trees, were in effect taking without payment an asset created for them by European capital and European enterprise. Nevertheless, the increase of the basic allowances of the Netherlands East Indies, in order to enlarge the quotas allotted to native areas, was a tacit admission that the future of the rubber-producing industry was bound to see an encroachment of native and individualist methods of production upon the system of European capitalism.

Tin

At the end of February 1931 the Governments of Malaya, Bolivia, the Netherlands East Indies, and Nigeria agreed on a scheme to regulate the production of tin. Siam afterwards joined the scheme, though on special terms. The average price of tin in London was £118 12*s.* per long ton in 1931, £136 in 1932, £194 16*s.* in 1933, and £230 8*s.* in 1934. Stocks, though increasing in 1931 and 1932, were reduced from an average of 42,700 long tons in 1930 to an average of 22,100 long tons in 1934. Nevertheless, the maintenance of the world price at the higher level was achieved only with the aid of an internationally organized pool, which systematically withheld supplies from the market. The pool was in private hands, but its controllers acted with the knowledge, and to some extent with the co-operation, of the International Tin Committee appointed to manage the restriction scheme. One

[1] This was a matter for dispute. A Batavian newspaper reported in March 1936 that the potential native production had been authoritatively estimated at not less than a million tons per annum.

other effect of the restriction scheme must be noted. Before it went into operation the five restricting countries had been responsible for a fairly steady proportion, about 92 per cent., of the world production of tin. In 1932 their share had fallen to 84·4 per cent., and in 1933 to 79·3 per cent. In 1934 there was some improvement in their relative position, but from the start of the scheme the competition of non-participating countries was a serious threat to its success.

In October 1933 agreements were signed for the continuance of the scheme among the five participating countries. The new scheme was to take effect from the 1st January 1934, and was to continue for three years from that date. The agreed standard tonnages of metallic tin under the old and new schemes were:

(In long tons)

	Old	*New*
Malaya	58,853	71,940
Bolivia	34,260	46,490
N.E.I.	29,910	36,330
Nigeria	7,750	10,890
Total	130,773	165,650

Siam was granted an exportable allowance of 9,800 long tons per annum, not subject to reduction by quota; and if the quotas allotted to the other countries were raised beyond 65 per cent. her allowance was to be increased proportionately.

The second important development in the tin restriction scheme was the adoption of what was known as the buffer stock plan. A memorandum embodying this plan was submitted in December 1933 to the Malayan Chamber of Mines in London. The memorandum argued that the reduction of stocks and the gradual liquidation of the private international pool were bringing the chance of a corner in tin, or of a 'bear raid' against it, close to reality. Manipulation of the quota rates would be too slow and cumbrous a means of defence. The following suggestions were submitted. Normal world stocks should be determined at an agreed figure, which, it was suggested, should be 15,000 to 18,000 tons, and the international quota should be so adjusted as to reduce stocks to this level within six months. Over that period a 'buffer stock',

amounting to some 8,000 tons of tin, should be accumulated in the hands of the International Tin Committee, by means of a special quota proportionate to the standard tonnages. The sole purpose of the marginal stock would be to prevent rapid and severe oscillations in price. It was suggested that the buffer stock might become self-regulating by means of a simple formula incorporating a basic price, which might either be invariable or be adjusted quarterly when the quotas themselves were under review.

The buffer-stock scheme at once encountered much opposition from interests in different branches of the tin industry. After its acceptance by the executive of the Tin Producers' Association, in January 1934, Sir George Maxwell resigned his chairmanship of the Association and was replaced by Sir Samuel Wilson. In a public statement Sir George Maxwell argued that before accepting such a scheme the producers and their Governments ought to have a definite policy with decontrol as its declared objective. The suggested figure of 15,000 to 18,000 tons, he thought, was dangerously small. The scheme took no account of the 8,000 tons of tin still unsold by the members of the private tin pool, and it was impossible, Sir George Maxwell declared, to avoid the conclusion that both stocks would be under the same management. The existing price of tin was a direct stimulus to production in non-participating countries; world consumption, which was the deciding factor in the industry, was still deplorably low. The Council of the Tin Producers' Association, however, unanimously approved the principle of the plan, and the new chairman issued a circular letter in its defence. As the quota agreement had only just been renewed for three years, the Council felt that it would be altogether premature at that stage to approach the question of its further renewal at the end of 1936. The plan was compared to a balancing tank in a water-supply scheme.

It was strongly opposed by a majority of producers in Malaya, especially the Chinese producers, who had all along been restive under restriction. A referendum was offered by the Colonial Government, but it was postponed while the Governor consulted with the Colonial Office, and was never

held. On the 5th June 1934 the International Tin Committee announced that the four signatory Governments had agreed to the formation of a buffer stock of tin, fixed at 8,282 tons. A special quota of 5 per cent. of standard tonnages had been sanctioned, for the purpose of accumulating this stock, the whole of which would be accumulated by the end of 1934. The stock would be under the control of a special committee, acting in accordance with general instructions issued by the International Tin Committee. The buffer-stock scheme was to expire on the 31st December 1935, unless the signatory Governments unanimously agreed to continue it.

The buffer stock had been fully constituted by the beginning of 1935, yet in April of that year a considerable backwardation (the premium on spot over forward delivery) began to appear, giving evidence of an acute scarcity of tin available immediately; and the authorities were apparently either unable or unwilling to release spot tin in order to correct the position. Dealers on the London Metal Exchange protested that although there were 4,600 tons of tin in London warehouses, a large part of which was buffer-stock tin, it was virtually impossible to buy—or borrow—any appreciable quantity for spot delivery. The backwardation rose to £21 a ton one day at the end of July. London stocks were reported to be diminishing at the rate of 400 to 500 tons a day, and 1,200 tons of buffer tin were shipped from New York to London in order to relieve the pressure.

It was apparent that the policy pursued by the International Tin Committee had resulted in a dangerous reduction of immediate world supplies of tin. The buffer stock, it was stated, had been reduced to about 1,000 tons, and total world supplies were in the neighbourhood of 14,000 tons. On the 9th August the Committee decided to raise the quota for the July–September quarter from 50 to 65 per cent. with retrospective effect. (At the beginning of 1935 the quota had been only 40 per cent.) But even this decision had to be rescinded, in view of the rapid absorption of all available supplies, and at the beginning of October the quota was raised to 70 per cent. with retrospective effect from the 1st July. Nor was this the end. In the middle of October stocks in the London market

fell to 430 tons, the lowest figure ever recorded, and the backwardation rose to £21 15*s*. on a spot price of £248 10*s*., the highest price for approximately seven years. The International Tin Committee then raised the quota to 80 per cent., with effect as from the 1st October. In December they announced that the quota for the first three months of 1936 would be 90 per cent.

Among the causes of the decline in stocks and the consequent relaxation of restriction was the rearmament boom that swept the world in the autumn of 1935. There were, however, certain more particular causes affecting the tin market. Sir George Maxwell's view that world stocks of 15,000 tons would be dangerously low appeared to have been justified, and the degree of restriction at the end of 1934 and the beginning of 1935 had certainly been too intense. The consumption statistics for 1934 had been obscured by the absorption of outstanding stocks. The increase of export quotas, suddenly seen to be necessary, could not at once remedy the deficiency of spot supplies, partly for special reasons like labour troubles in Bolivia, partly because under the restriction scheme producers had been prevented from accumulating any considerable stocks in hand.

In spite of the fall in price that followed the enlargement of export quotas, the International Tin Committee could look back on the record of 1935 with some satisfaction from their own point of view. The average price of tin had been profitable to the vast bulk of producers, and highly profitable to some. The buffer stock had been successfully liquidated, presumably at a profit. World production of tin had increased from 108,000 tons in 1934 to 138,000 tons in 1935, and world consumption had increased from 117,000 tons to 142,000 tons. The 90 per cent. quota, however, was equivalent to an output of about 190,000 tons a year, and there was little surprise when it was cut to 85 per cent. for the second quarter of 1936. The immediate result, however, was a renewed shortage of free tin on the London market, where the backwardation rose again to £10 a ton. A special sub-committee of the London Metal Exchange interviewed the Secretary of State for the Colonies (as being responsible for official Malayan and

Nigerian policy), to plead that the reduced quota would delay the replenishment of stocks that was necessary if normal conditions were to obtain on the London market and if the welfare of British consuming industries was to be safeguarded. Mr. J. H. Thomas replied, in effect, that, since any decision of the International Tin Committee must be unanimous, the British delegates had no power to enforce an increase. This assertion, of course, emphasized the British Government's responsibility for the decision actually taken, whether sound or unsound.

The shortage of prompt supplies of tin, in spite of the nominal excess of the quota rate over the rate of consumption, was caused chiefly by the failure of Bolivia to fill her allotted quota. By the end of May her arrears had risen to 10,016 tons. The shortage of labour and the deterioration of plant, resulting from the war with Paraguay and from other causes, had made it impossible for her to maintain her productive capacity. Her *liberum veto* thus stood in the way of any increase of quota allowances, from which she could gain no advantage through larger output, but only loss through lower prices. After two postponements, the International Committee decided to raise the quota to 90 per cent. for the third quarter of 1936, the increase of 5 per cent. being intended, it was stated, to offset Bolivia's arrears. The closing price of cash tin in London on the day of the announcement was £181 12*s.* 6*d.*

Copper.

The problem of regulating production was much more complicated in the world copper industry than in the rubber and tin industries. In the first place, the leading copper-producing country, the United States, was also the greatest consumer of copper. This opened up the possibility of large-scale dumping, under the shelter of a high tariff to protect the American producers. In the second place, the international distribution of output in the copper industry was passing through a period of instability and change. In 1925 the United States was responsible for 54 per cent. of the output from copper-mines throughout the world; in 1929 her share was 46·4 per cent., and by 1933 it had fallen to 17 per cent.

Meanwhile, great new copper-fields in Central Africa were being brought into a condition of large-scale production, and Canada and the U.S.R.R. were also steadily expanding their output. In the third place, a considerable proportion of world copper-supplies, especially of Canadian copper, was obtained as a by-product of the extraction of gold, silver, nickel, and other minerals. For those who produced copper in this way, price was a secondary consideration, and restriction of output was undesirable, if not impossible.

So long as the United States maintained her dominating position in production, the leadership in schemes of restricting supply came also from her; the three great pre-slump cartels in the industry—the Copper Producers' Association, formed in 1908, the Copper Export Association, formed in 1919, and Copper Exporters Incorporated, formed in 1926—were all controlled by United States interests. Copper Exporters Incorporated was primarily a price-fixing organization, and partly as a result of its efforts by March 1929 the price of electrolytic copper was over 24 cents a pound, equivalent to a London price of over £70 a ton for standard copper. The weakness of the situation lay in the difficulties of the so-called customs smelters in the United States. These were smelters of copper who did not mine their own ore but relied on supplies from other sources, more particularly from by-product output, and who suffered through their inability, under restriction, to use their plant to full capacity. They had a valuable ally in the dealers on the London Metal Exchange. In April 1929 the cartel was forced to allow the customs smelters to sell below the fixed export price, and the hole in the dyke rapidly widened as the flood of American customs copper poured through it into the gulf of the London market. In the first fortnight in April 1929 the London quotation fell from £71 a ton to £59 a ton. The collapse was staved off for a while, but in 1930 prices slumped again, and Copper Exporters Incorporated disappeared.

Although the American producers were still strong enough, or desperate enough, to restrict production among themselves, the price they paid was a swift decline in their share of world output. In 1933, while the United States was restricting mine

production to below 20 per cent. of 1929 output, the rest of the world was producing over 80 per cent. of its output in the peak year. The United States had been threatened with the influx into her domestic market of copper produced much more cheaply, and without restriction, in other countries, and in July 1932 the American Government had imposed an import duty of 4 cents a pound on raw copper.

Outside the United States the most striking development of this period was the rapid entry of the Northern Rhodesian mines into full production. Their annual production before 1931 remained well below 10,000 tons, but in that year it rose to some 20,000 long tons, and by 1934 it was 137,897 long tons. Moreover, the mines had by no means come to the end of their capacity to expand. Similar in technical character, though with a longer history of development behind them, were the mines of the Belgian Congo. Their output fell from 137,000 metric tons in 1929 to less than half that figure in 1932 and 1933; in 1934, however, output was once more increased to 110,000 metric tons, and development and exploration were being pushed forward. The curve of production in South America (principally Chile) was roughly similar to that in the Congo. In 1929 output had totalled 384,000 metric tons; in 1932 it was down to 126,000 metric tons; but in 1934 it was back to 266,000 metric tons. The cost of production in Chile was relatively very low, partly because copper was found in valuable combination with gold and silver. Here the monetary metals were by-products; in Canada, on the other hand, it was usually copper that was the by-product of the mining of gold, silver, and particularly nickel. The high price of gold in the depression period, and the sharp recovery in the prices of silver and nickel to very profitable levels, meant that the check of low copper prices on Canadian production was at a minimum. Canada's output, which reached a peak of 303,500,000 pounds in 1930, fell only to 247,700,000 pounds in 1932, and two years later it rose to the record level of 367,100,000 pounds.

The National Industrial Recovery Act inaugurated a new phase in the history of the world copper market. The N.R.A. code for the copper industry, adopted in April 1934, allotted

20,500 tons of copper monthly to primary producers, and 9,500 tons to secondary producers. Customs smelters would temporarily have a sales quota of 50 per cent. of current production imposed on them. The 'Blue Eagle' price for electrolytic copper was to be 9 cents a pound, but consumers were disinclined to buy at this figure, and in the summer of 1934 it could no longer be maintained in practice. Difficulties also arose from the customs smelters, who could scarcely make a profit while working at half capacity, and who had to be allotted part of the producers' quotas. From the point of view of producers outside the United States, a danger lay in the possibility of heavy sales abroad, at well below 'Blue Eagle' prices, of copper from the large American stocks—some 550,000 tons—that existed when the code began to operate.

In spite of these difficulties and dangers, the introduction of the code was the signal for agitation in the United States, in Great Britain and elsewhere, for the arrangement of an international copper restriction scheme. The Rhodesian and other copper companies outside the United States, aware of their strong bargaining position, were cautious and reserved, but an international producers' conference was held in New York in March 1935, and at length signed an agreement for the restriction of output. The conference, it was stated, had been concerned exclusively with the situation outside the United States, the latter market being closed by the 4 cent. tariff and organized by the copper code. It had been attended by representatives of companies producing more than three-quarters of world primary copper production outside the United States, exclusive of Japan and the U.S.S.R., which were importers as well as producers. Production by the participating countries, it had been agreed, was to be reduced by 240,000 tons of copper per year from the current rate, beginning on the 1st June 1935. Co-operation in non-American markets of producers other than those actively participating in the conference had been assured. There was to be no pooling of sales or fixing of prices, but an effort was to be made to ensure stable markets and avoid wide fluctuations in price. Unless interrupted by certain contingencies, the accord was not to expire until the 1st July 1938. Nothing

was officially said about the participation of United States exporters in the scheme, but it was generally understood that a 'gentlemen's agreement' had been entered into for the limitation of American exports to 8,400 tons a month, in place of the rate of over 12,000 tons a month at which they had previously been running.

At the time of the agreement, production of copper outside the United States had reached a rate of about a million tons a year, with consumption running at about the same level. American exports were responsible for an additional 150,000 tons or so a year. The restriction scheme entailed a reduction of nearly 300,000 tons a year in the supplies available on importing markets, provided that the by-product producers and the scrap-copper mills did not substantially increase their output. Hence stocks outside the United States might be expected to decline at approximately the same rate at which they had been increasing before June 1935.

As a consequence, the price of standard copper in London, which stood at £28 6*s*. 3*d*. a ton at the opening of 1935, rose to a peak of £34 16*s*. 10½*d*. a ton in May. Then came a relapse. On the 27th May 1935 the United States Supreme Court declared the major provisions of the National Industrial Recovery Act unconstitutional. At the end of June the United States Copper Association decided to abandon the N.R.A. code as far as selling quotas and so on were concerned, keeping only the fair-practice provisions; simultaneously it decided to reduce the domestic price of copper from 9 cents to 8 cents a pound. In London, the cash price of copper promptly fell below £29 a ton. That, however, was only a momentary reaction. The prospect of maintaining the restriction agreement greatly improved as American consumption increased in the summer months. After September 1935 the United States domestic price was progressively raised, and the London price followed in its wake.

For the time being, equilibrium had apparently been reached in world copper markets. Copper consumption outside the United States was estimated to have risen from 1,072,000 tons in 1934 to 1,205,000 tons in 1935, while production rose from 1,027,000 tons to 1,110,000 tons. Total

supplies outside the United States, including secondary metal and American exports, were estimated at 1,267,000 tons. World consumption of copper outside the United States was higher in 1935 than in any previous year, higher even than in the boom years 1928 and 1929. Here again there was a sharp contrast between the United States and the rest of the world; for in that country consumption was estimated at only 470,000 tons in 1935, against an average of a million tons in the boom years.

Other Commodities

The restriction schemes for rubber, tin, and copper were much the most striking and the most important in force in this period. Brief mention, however, may be made here of one or two others. In July 1934 a pact was negotiated between the principal producers of synthetic nitrate and representatives of the Chilean industry. Since 1932 a cartel, the 'Confédération Internationale de l'Industrie d'Azote', had been in existence among the European producers, guaranteeing domestic markets, regulating exports by quotas, and arranging for the closing of large new plants in Belgium and Holland on payment of compensation. Chile, however, remained outside the cartel and endeavoured to recover some of her lost markets by under-cutting prices. Ever since 1928 the world nitrate industry had suffered from greatly excessive capacity to produce, largely by reason of the protection given by almost every country in the world, for strategic purposes, to a domestic nitrate industry. Thanks to this defence of home markets, synthetic production, though sometimes carried on at a loss, was not greatly curtailed when the world depression came, but Chilean production fell from a nitrogen equivalent of 464,000 metric tons in 1929–30 to only 71,000 metric tons in 1932–3.[1] By the agreement of July 1934 Chile was allocated quotas in all the principal European markets except Poland, and in Egypt, totalling 720,000 metric tons of nitrate per annum; and it was estimated that she could sell an additional 450,000 tons in the United States, Japan, and other markets

[1] The nitrogen equivalent of Chilean nitrate was approximately 1 ton of nitrogen to 6½ tons of nitrate.

not covered by the agreement. At the same time, in order to prevent under-cutting, a sliding scale was laid down for the relation between the prices for synthetic and for Chilean nitrate. The agreement was concluded for one year only, and when it expired in July 1935 prolonged difficulties blocked the way to a new pact. In September, however, agreements that had been initialled in the previous July were definitely signed, continuing the export quota system on the same lines as before, and including also provisions for the regulation of prices. Details were not published. The agreement was to last for a period of three years from the 1st July 1935, but might be terminated after two years 'in certain circumstances'. It was understood in market circles that Chile's export quota had been raised to 1,250,000 tons, including the uncontrolled markets.

At the end of 1935 an arrangement governing exports and prices was entered into between the European and the Japanese synthetic nitrate syndicates.

In the early stages of the world depression, tea-planters resorted to finer plucking as a corrective for over-production, and their efforts were successful in preventing any fall in the prices of tea comparable with those suffered by raw material industries like rubber and tin. Nevertheless, the prices realized were unremunerative and world stocks increased threateningly. At the end of 1932 the producers of Ceylon, India, and the Netherlands East Indies agreed severally to schemes of export restriction, which were later co-ordinated into an international restriction scheme. The latter went into force in April 1933. Standard allowances were based on exports in 1929–31, and an International Tea Committee was empowered to decide for each year the degree of restriction which was to be enforced by the different Governments. The signatory countries also undertook to prevent any increase of the area under tea. The export quota, which for the first year of the scheme had been fixed at 85 per cent., was raised to 87½ per cent. for the second year (1934–5), but a rise in stocks caused it to be cut to 82½ per cent. for 1935–6. In their report on the second year's operation of the scheme, the International Tea Committee acknowledged that too much tea seemed to

have been released up to April 1935. But still worse consequences, they declared, might have followed a failure to raise the quota for the second year, since dealers had adopted the view that even an $87\frac{1}{2}$ per cent. quota would not afford a sufficient supply of tea; hence they had drawn to a considerable extent upon China and Formosa, who were outside the scheme, to replenish their stocks. Prices remained weak, and the International Tea Committee decided to keep the export quota at $82\frac{1}{2}$ per cent. for 1936–7. The continuance of restriction at this rate, however, enlarged the threat of encroachment by supplies from China, Japan, and Formosa. The Committee had from the first been concerned to secure the co-operation of other countries; but, apart from an understanding with the British Government and the Kenya planters that the East African tea area would not be extended by new planting, their efforts had produced no substantial result. There was also the possibility, of course, that a rise in prices might check consumption; the Committee, however, was making striking attempts, financed by an export cess, to expand by propaganda the consumption of tea in Great Britain, the United States, and elsewhere.

The sugar industry was similar to the nitrate industry in this important respect, that, in both, a natural product produced in areas far from the consuming countries had to compete with a heavily subsidized and protected industry in the latter. But whereas the great impulse to the production of synthetic nitrate was given by the War of 1914–18, the same cause favoured the cane-sugar industry at the expense of beet; for the main beet-sugar areas (Germany, Hungary, Czechoslovakia, Poland, and Belgium) were either blockaded or occupied, and the cane-sugar producers were given a clear field. At the turn of the century the proportion of cane-sugar to beet-sugar in world production (which had been 7 to 1 in the 'fifties) had been only 1 to 2, but then came the Brussels Sugar Convention of 1902, and in the last pre-War year the ratio of cane to beet was 5 to 4. After the War, cane-sugar accounted for no less than three-quarters of world sugar output. By 1934, however, in spite of a further increase in cane-sugar supplies, they constituted less than 60 per cent. of the

world total. State protection for beet-sugar had become more extravagant than ever, and extended even to Great Britain, who had not been a party to this extravagance before the War. In certain countries the price of sugar was maintained, for the benefit of home producers, at a level over ten times as high as the world price. In consequence, demand was checked, and consumption fell from 26,900,000 metric tons in 1930–1 to 24,100,000 tons in 1932–3.

In May 1931 the so-called Chadbourne Plan was agreed upon by representatives of the sugar industries of Cuba, Java, Germany, Poland, Czechoslovakia, Hungary, and Belgium. The scheme attempted to restrict supplies by means of export quotas, and aimed at clearing away surplus world stocks by 1935. The adherents of the plan loyally fulfilled their obligations to curtail their exports, but the scheme was frustrated by the countries outside its scope, notably British colonies and the United States and its dependencies, such as the Philippines and Hawaii. From an average of 13*s.* per cwt. in 1927, the open market price of sugar dropped to 6*s.* 3¾*d.* in 1931, and to 4*s.* 8½*d.* in 1934. At one time it fell to 4*s.* per cwt. The Chadbourne Plan expired, according to its terms, on the 31st August 1935; and in spite of prolonged efforts it proved impossible to renew it. Java demanded complete liberty of action, but the other signatories formed a new committee to 'maintain close and mutually beneficial relations' between the various countries. The leadership in promoting new plans for the regulation of the world sugar industry was left to Great Britain.

World Sugar Production

(In millions of long tons)

	Chadbourne group	*United States*	*British Empire*	*Other countries*	*Total world*
1929–30 . .	12·5	3·5	4·6	6·7	27·3
1933–4 . .	6·1	5·0	7·4	6·6	25·1

The British Government appointed a committee in 1934 to consider the future of the local sugar-beet industry. They subsequently rejected, however, the conclusion of the majority

of the committee that the subsidy should be progressively abandoned, and adopted instead a plan limiting the subsidized output to 560,000 tons of white sugar, adjusting the rate of subsidy in inverse relation to the market price of sugar, and consolidating the refining interests. The Government proposed 'to invite the Governments of the sugar-exporting Dominions and Colonies to examine with them the possibility of a joint endeavour to reopen international negotiations', if there appeared to be a reasonable prospect of success. After they had consulted with the Empire producers, the Government let it be known, in October 1935, that they proposed to submit to foreign countries, at a favourable moment, a plan for the limitation of sugar production to the highest level reached in the past three or four years, less a moderate percentage.

The danger of increased production by countries not participating in restriction, so vividly translated into fact in the sugar industry, was naturally present in a high degree when the restriction was conducted by a single country, even though it might originally hold a dominating position in world markets. In 1924 Brazil had introduced a law for the 'permanent defence' of the price of coffee, but the world slump, surmounting a succession of bumper crops in Brazil, brought the scheme to an end, and it was wound up in 1930. Brazil did not, however, cease her attempts to raise the price of coffee; and between 1930 and May 1935 she deliberately destroyed 35 million bags of coffee of 60 kilograms each; the National Coffee Department was by this time heavily loaded with debt, and Brazil's credit abroad had practically disappeared. Meanwhile, she had been losing markets to other coffee producers. In 1923–4 the production of coffee outside Brazil had amounted to 5,700,000 bags; in 1932–3 it had risen to 9,200,000 bags; and even in 1934–5, a bad crop year, it was 7,700,000 bags.

In another primary industry, however, that of raw cotton, Brazil benefited by the very process that was undermining her world dominance in coffee. The Bankhead Cotton Act in the United States applied to the cotton plantations the principles of the Agricultural Adjustment Act, namely, a payment to

growers in return for a limitation of acreage. At the same time, the United States Government directly supported the price of cotton by offering to lend to growers 12 cents a lb. on the security of their cotton, a rate appreciably above the free market price. In consequence, buyers restricted their purchases of American cotton, the principal beneficiaries of this redirection of demand being Brazil, British India, and Egypt. The United States authorities were apparently anxious in 1935 to negotiate an international agreement for the limitation of cotton production, an anxiety that may be well understood, but the response from other producing countries was negative. The decisions of the Supreme Court in 1936 against the system of processing taxes seemed to foreshadow a relaxation of subsidized restriction in cotton as in other agricultural industries, and the later policy of the United States Administration leant towards the progressive liberation of Government-held stocks of cotton. As a result, United States cotton recovered in 1936 some of its lost share of world markets.

The regulation of oil production in the United States under Federal authority encountered even graver constitutional obstacles than the restriction of cotton-growing. Control of oil output and trading was attempted under section 9*c* of the National Industrial Recovery Act from September 1933 onwards, but after a series of practical setbacks and adverse judgements in lower courts it was declared unconstitutional by the Supreme Court, in the case of the Amazon Petroleum Corporation, on the 7th January 1935. Federal regulation of output was then replaced by state regulation, and by federal control of inter-state shipments of oil produced in excess of state allowances. An Inter-State Compact, entered into by a majority of the oil-producing states, afforded a parallel with the international restriction agreements for commodities like tin or rubber. Thereupon the alliances shifted in the battle for and against oil restriction in the United States. Previously the Federal Government had fought both the State Governments and the producers; now most of the State Governments, with the support of the leading producing companies, fought for restriction against recalcitrant producers of 'hot oil'. The effort was successful in 1935. In spite of a large increase in

American production, crude oil stocks in the United States fell by over 22 million barrels in 1935, and prices were raised by 10 cents and in some fields by 15 cents a barrel. The rising level of demand, both in domestic and in foreign markets, more than offset the flaws in the regulation system. The United States dominated the world petrol industry, and the check to the production of 'hot oil' in that country had an immediate effect on world markets.

In this period of world economic history the international restriction schemes, with the notable exception of the Chadbourne Plan for sugar, held together in spite of difficulties and dangers, and often succeeded in engineering a very profitable rise in prices. At the end of 1935 the three restriction schemes for rubber, tin, and copper were worth to the producers of those commodities some £50 millions per annum, on the assumption that in their absence prices would have remained near the level at which they stood when restriction first seemed probable to market operators. Most of this charge, which was being paid by the consuming industries and almost certainly being passed on to the final consumers, was coming back to European countries and North America in the shape of higher dividends. Comparing this picture with the very different scene depicted in Chapter II, one is forced to the conclusion that the comparative success of the restriction was due as much to the general economic circumstances of the time as to the inherent strength of the schemes themselves. When once the stocks in the hands of consumers and intermediaries had been brought to a low level, and circumstances had forced down costs of production to a rate that allowed some hope of profits at a lower level of world prices, restriction began to succeed in its aims, and success bred success. It would have bred eventual failure, nevertheless, had the rise in prices caused a large diversion of demand to alternative products, and this danger always hovered near; but by 1935 the activity of most manufacturing industries was increasing, almost all products shared in the rise of prices, and hence there could be no permanent refuge for consumers in alternative materials or sources of supply. In brief, restriction hastened and extended an upward movement of prices that would have

resulted in any case from the operation of more normal economic forces.

Colonial empires, it will have been noticed, were far from being exclusively responsible for the deliberate raising of prices by the limitation of supply. In two great industries, wheat and sugar, the responsibility for the unhappy condition of world markets lay chiefly upon importing countries, which maintained artificially high prices within their own borders, thus automatically limiting consumption and leaving exporters no alternative but to regulate supply to the remaining import demand. The United States complained bitterly of the injustice of raising against her the price of tin and rubber, for the benefit of the British and Netherlands Empires; but in the restriction of copper, of wheat, of cotton she played a leading and decisive part; and it was American interests that sponsored the Chadbourne Sugar Plan. The countries that bore the greatest burden through the raising of prices by restriction of supply were those that neither produced the raw materials and foodstuffs themselves on a scale commensurate with their needs, nor obtained compensation through an increased return on their investments in producing countries. Even these countries were compensated in so far as they were able to sell a greater volume of exports to more prosperous primary producing countries, but in this direction they were largely handicapped by tariffs and preferences.

(b) *Silver*

At the end of 1933 President Roosevelt made known his decision to ratify the London Silver Agreement,[1] which had been negotiated in the course of the World Economic Conference. He also announced that in accordance with permissive legislation the Treasury was prepared to buy 24 million ounces a year of newly mined American silver, not more than one-half to be coined and the remainder to be retained by the Treasury for seigniorage. This would give a maximum

[1] See above, p. 202. Canada and China decided in February 1934 to ratify the agreement, but China was reported to have made the reservation that she would withdraw if the agreement failed to secure its purpose, namely, stabilization of silver prices.

price of 64·5 cents an ounce to American producers, compared with a current open-market price of 43 cents an ounce. This move, though gratifying to the powerful silver interests in the United States, pushed up world silver prices by only a small percentage; for American production represented no more than 15 per cent. of the world output of silver (1932 figures), and the offer to purchase was tendered only to domestic producers. In the course, however, of his message to Congress on the 22nd May 1934, Mr. Roosevelt said:

> 'We have since acquired other silver in the interest of the stabilization of foreign exchange and the development of a broader metallic base for our currency.'

The Silver Purchase Bill, which was signed on the 19th June 1934, directed the Treasury to buy silver, until a quarter of the reserves against currency should be composed of that metal, at a price not lower than 50 cents an ounce. It empowered the President to order the nationalization of all silver stocks held in the country—a step which he took on the 19th August following. It authorized the Treasury to issue silver certificates backed by 100 per cent. silver, up to the total of the silver purchased under the Act. The price of silver on American markets, after the implementation of the Act, was at first pegged at 50 cents an ounce. The London price, which had been $18\frac{9}{16}$*d.* an ounce just before the announcement of December 1933, rose to $21\frac{7}{16}$*d.* an ounce when the Silver Purchase Act went into force, and continued to rise; by mid-November it was $25\frac{1}{4}$*d.* an ounce. Record shipments of the metal crossed the Atlantic, but far more serious in its effects was the drain from China. Between June and August 1934 stocks of silver in Shanghai fell by 100 million ounces, in spite of constant replenishment from the interior. The American policy was doubly disastrous to China; it directly depleted her monetary reserves and coin in circulation, and it caused a violent appreciation of her currency on the foreign exchange market, with all its adverse consequences for her external trade. In February 1934 Sir Arthur Salter had written in his report as special economic adviser to the Nanking Government:

'It is, I think, impossible to examine the record of the last four years without coming to the conclusion that China benefited substantially in 1930 and 1931 from the fact that the depreciation of silver in terms of gold was saving her from currency deflation, and that its appreciation has been a substantial factor in the deterioration of the last two years. In any case it may be said with confidence that a rise in the world price of silver that is out of line with world prices of commodities in general is certainly, in its results, injurious.'

The Chinese Government's reply to American policy was to impose, on the 15th October, a sliding-scale tax on silver exports, designed to make export unprofitable at whatever rate of exchange was ruling—in other words, the equivalent of an embargo. The Shanghai dollar then fell from 18½*d.* to 16*d.* China had been, in effect, forced off the silver standard as far as her international currency relations were concerned. The internal deflation nevertheless continued; for the hoarding of silver went on in the expectation that the currency would be devalued or the export restrictions relaxed. Moreover, the ease and profitability of smuggling rendered the export tax only partially effective in arresting the drain of silver.

In a note of protest to Washington, the Chinese Government had stated that China was considering the gradual introduction of a gold-basis currency, and had inquired whether in principle the American Government would be willing to exchange gold for silver. The Secretary of State replied that free world markets for gold and silver were open, but that his Government were willing to discuss at any time the possibility of inter-governmental transactions.

At the time of the passing of the Silver Purchase Act the United States Government's stock of silver was estimated at 691 million ounces, while the holding at the end of 1934 was estimated at 1,003 million ounces. Of the 312 million ounces acquired in the meantime, about 111 millions were received under the nationalization order and 21 millions from newly mined American silver purchased at 64½ cents an ounce. The amount secured from abroad, therefore, appeared to be about 180 million ounces. Shanghai stocks of silver fell by 177 million

ounces in the course of 1934, and the same round figure approximately represented the year's output of newly mined silver in all countries of the world. On the basis of United States stocks of gold at the end of 1934, the total quantity of silver required to bring the ratio between the two metals to 3 to 1 was about 2,130 million ounces, of which less than one-half was already in hand.

In 1935, as a result of developments of American policy, there ensued a series of crises in world silver markets. On the 10th April the United States Treasury's buying price for newly mined silver was raised from $64\frac{1}{2}$ cents to 71 cents per ounce. Although there was no guarantee of American purchases of foreign silver at a higher price, the immediate reaction in the London market was a rise in the price of silver from $28\frac{15}{16}d.$ to $31\frac{5}{16}d.$ an ounce. By the 25th April the price was $32\frac{13}{16}d.$ an ounce. On that day the American buying price was raised again to 77·57 cents an ounce, by the reduction of the seigniorage tax to 40 per cent., and the Secretary of the Treasury declared that the Treasury would continue to purchase newly mined silver until the price reached $1·29 cents an ounce, or until the national stocks of silver reached the statutory ratio of 25 per cent. of the metallic reserves against currency. Since there appeared to be no prospect of the ratio's being attained by the acquisition of American silver alone, world silver markets instantly burst into a speculative boom that drove prices above parity with the United States buying price. The Secretary of the Treasury, Mr. Morgenthau, indicated that the Treasury's policy for the time being was to watch the course of world silver prices 'as an interested spectator'.

Their interest must have been stimulated by the decision of the Mexican Government, on the 27th April, to call in all silver money from circulation; the rise in the price of the metal threatened to make the bullion value of the peso greater than its face value, and therefore to render profitable the melting down of coins. All owners of silver coins were ordered to hand them over to the Bank of Mexico within thirty days, in exchange for inconvertible paper currency. It was rumoured that the Mexican Government were contemplating the stabili-

zation of the peso against the dollar at 3·50 pesos to the dollar. Similar apprehensions were beginning to be felt in India, the metallic value of whose coinage would equal its monetary value if the price of silver rose to 48·7*d.* per ounce. Above that point a large-scale tendering of notes for conversion into silver might be expected, an eventuality for which the Reserve Bank was ill prepared. Meanwhile, in spite of the ban on exports of silver, the exchange value of the Chinese currency was being enhanced by the rise in silver prices, and the economic difficulties of China were in that measure being intensified. Between the autumn of 1934, when China abandoned the international silver standard, and the end of April, when speculation drove prices in New York up to 81 cents an ounce, the Chinese dollar had appreciated by 24 per cent. The world price of silver, however, had meanwhile risen by 66 per cent., and the whole of this appreciation was passed on to the Hong Kong dollar, with consequent injury to the economy of the colony. On the 10th June the Government of Hong Kong ordered that after the 15th June no person should export from the colony to any country other than China any Chinese silver coin or any silver bullion, other than silver bars produced in refineries outside Hong Kong and China, except by special licence. It was at this juncture that the British Government in the United Kingdom announced their intention of sending their Chief Economic Adviser, Sir Frederick Leith-Ross, to the Far East in order to investigate and report upon the economic situation in China.

After the boom in April, prices on world silver markets sank steadily, because there was no economic foundation for their higher level except the expectations raised by American policy, and the American Treasury gave no signs of buying silver on a large scale outside the United States. By the beginning of July the price in London was down to 31*d.* an ounce, from a peak of over 36*d.* On the 8th July a crisis developed, as a result of heavy sales from Eastern markets, where speculators were apparently in a weak position. In order to prevent a collapse of prices the American Treasury intervened with offers to purchase, at the market price, unsold silver on offer at the end of the day, and in the space of three weeks the

Treasury bought 60 million ounces in London. Prices recovered for a while, and for over three weeks remained steady at about $30\frac{3}{16}$*d.* an ounce. Then in the middle of August the American buying price was lowered to 29*d.*, a move that caused panic among speculators and forced the United States Treasury to buy over 25 million ounces in a single day.

The Chinese dollar depreciated with the fall in the price of silver, but the depreciation was inadequate to afford any economic relief, and the premium on silver widened doubts about the future of the Chinese currency. On the 3rd November 1935 the Nanking Government announced a sweeping series of monetary reforms, establishing in effect an inconvertible paper currency in China. The bank-notes issued by the three Government Banks were to be full legal tender, and their note reserves were to be placed under unified control, together with the note reserves of all other issuing banks. The notes of these other banks would be gradually withdrawn and replaced by notes of the Central Bank of China, which was to be reorganized as a central reserve bank. All debts expressed in terms of silver would be dischargeable by payment of legal tender notes of the nominal amount due. The use of silver dollars or bullion for currency purposes was prohibited, and all holders of silver were required to exchange it for notes. A Currency Reserve Board was to be formed to control the issue and retirement of the legal tender bank-notes, and to keep custody of the reserves. Shares of the Central Bank would be owned principally by the banks and the general public, and it would thus hold the reserves of the banking system and act as a depository of all public funds. After two years it would enjoy the sole right of note issue. The exchange value of the Chinese dollar would be kept stable at the existing level, and for this purpose the Government banks would be authorized to buy and sell foreign exchange in unlimited quantities.

The announcement continued:

'Measures which have been prepared for strengthening the commercial banking system, giving increased liquidity under sound conditions to the commercial banks, include the creation of a special institution to deal exclusively with mortgage business.

Plans have been completed whereby the national budget will be balanced within eighteen months. The Government is determined to avoid inflation and will take energetic measures to deal with speculation and attempts to bring about unwarranted increases in prices.'

On the 4th November the exchange stabilization committee set up by the Chinese Government announced that the official rate for sterling would be fixed at 1*s.* 2½*d.*; and, following this decision, the export duty on bar silver was raised to 65 per cent. It was pointed out in London—where, on the whole, the scheme was well received—that, on the basis of the theoretical parity with silver, this implied a devaluation of the Chinese currency by 40 per cent., and that the sterling exchange rate was the lowest, save for a brief spell in 1933, that had ruled since the period of heavy depreciation began in 1929. In that year, the tael had been worth exactly twice the sterling price at which it had now been fixed. The conclusion was drawn that it might well prove to be under-valued at its new level. It had to be borne in mind, however, that other currencies of great importance to China, notably the Japanese yen and also the Australian and New Zealand pounds, had meanwhile depreciated considerably against sterling and the American dollar.

On the 6th November the virtually independent Government at Canton endorsed the Nanking Government's plans for currency reform, and ordered them to be brought into force within their jurisdiction. The Hong Kong dollar also followed the Chinese dollar in this reorganization. On the 9th November an embargo was placed on the export of silver coin and bullion from the colony, and on the 5th December it was announced that all silver stocks would be taken over by the Colonial Treasury, and that an exchange fund would be set up to regulate the external value of the currency.

On the 17th May 1936 the Chinese Minister of Finance denied that the currency was to be linked with any foreign monetary unit. The reserves against the note issue would consist of gold, foreign exchange, and silver. The silver portion was to amount in value to at least 25 per cent. of the note circulation; at present, however, the gold and foreign exchange

portion was to be increased. The Finance Minister laid stress on the fact that since the reforms of the 3rd November the value of the Chinese currency had been divorced from the price of silver in world markets. Indeed, while the price of silver had fallen from about 29*d*. an ounce to about 20*d*. the paper tael had stayed near the 'pegged' level of 1*s*. $2\frac{3}{8}$*d*., or 29·5 U.S. cents. Interest rates had been reduced, and the success of the scheme of reform in exchanging notes for silver currency and in relieving the acute monetary stringency that had preceded it was illustrated by the expansion of the note circulation from 302,500,000 dollars at the beginning of November 1935 to 522 million dollars at the end of January 1936. In his report to the annual meeting of the Bank of China in April 1936 the Chairman, Mr. T. V. Soong, said that the remarkable steadiness of the exchange had stimulated China's exports and discouraged imports, with the result that since December, for the first time in sixty years, the trade balance, as shown by the Customs figures, had been favourable. There had been a gradual recovery of confidence, easier money conditions, and a perceptible revival of business activity.

The divorce of China from the silver standard was the most important result of the American policy instituted under the Silver Purchase Act of 1934. But the United States authorities did not rest from their disturbance of world markets for silver, nor indeed could they, for they were fettered upon a treadmill of artificial manipulation, every turn of which inevitably made its repercussions felt throughout the world. If they bought silver on world markets, or if they raised their internal buying price, there was an immediate speculative reaction; if they refused to buy, the world price structure for silver, having no firm economic foundation, creaked ominously, and its frailty exposed the hollowness of the internal buying policy itself. The American Treasury was like a lad blowing up a balloon. Every puff meant that a stronger puff was needed next time; if he continued blowing, the balloon might burst in his face; if he stopped blowing, the pressure of the air already inflated would drive a draught down his own gullet; if he removed the whole thing from his mouth he would lose his pretty balloon. The process of tying a knot round the mouth of the balloon,

by fixing the price of silver once and for all, and offering to buy world silver at that price, was ruled out by the need for placating the 'silver Senators' and other agitators by doing service to the objective of raising the price to \$1.29 cents an ounce.

The speculative volatility of world silver markets was enhanced by the apparently deliberate mystery in which American policy was shrouded. On the 9th December 1935 the American authorities suddenly withdrew their support from the London market, and only after frantic communications were they induced to buy a quantity of silver in the late afternoon. On the following day no support at all was forthcoming, and dealers, faced with selling orders for 20 million ounces of silver and no buyers, were forced to abandon the attempt to fix a price. From the 9th December to the end of the year no quotation for forward silver could be made in the London market. On the 12th and 13th December the American Treasury made small purchases, the price on the latter day being $26\frac{7}{8}$*d.* an ounce, and the Secretary of the Treasury made it known that they had been buying silver in various markets, instead of only in London as hitherto. The London dealers could now make only a pretence of opening a free market for silver. A price was fixed each day, but sellers were rationed according to the quantity that the American Treasury was willing to buy. On the 24th December the price fell to $20\frac{7}{8}$*d.* an ounce, the lowest quotation of the year, and little more than a penny above the price in June 1934, when the Silver Purchase Act became law. It was revealed that stocks of silver in Bombay had been reduced by about 20 million ounces as a result of American buying, and that large sales had been made from the Chinese Central Bank direct to the United States, 'in order to provide additional reserves for exchange stabilization'. The United States Government had also acquired the whole of Mexico's output of newly mined silver during 1935. Restocking by Eastern markets, and the withdrawal of selling orders, helped to relieve the pressure on London, and by the end of the year the price had risen to $22\frac{1}{2}$*d.* an ounce, but it later fell again.

On the 26th December 1935 some light was thrown on the profundities of American policy by a spokesman of the

Treasury. The Administration, he indicated, might resume its efforts to raise the world price of silver when once China had solved her most pressing problems. Meanwhile it was desired to check the smuggling of silver out of China via Japan, and to give her a breathing spell in which to carry out her silver nationalization policy. The United States Treasury, it was hinted, would then seek to negotiate an agreement with China, defining the future position of silver in her economic organization. Mexico and other countries having substantial silver supplies would also be encouraged to adopt monetary reserves partly of gold and partly of silver. The United States would be prepared to supply these countries with gold in exchange for silver to an extent sufficient to put into practice any scheme that might be negotiated. On the 7th January 1936 Mr. Morgenthau, after conferring in Washington with the Secretary of the Mexican Treasury, announced that their conversations had resulted in a 'mutually satisfactory agreement'. On the 13th February he made it known that the United States had bought 50 million ounces of silver from China in the previous November, paying the then prevailing price of 65 cents an ounce. They had bought, in all, 69 million ounces of silver from China.

At the time of this announcement the silver stocks of the United States Treasury totalled 21·8 per cent. of the gold reserves, to which ratio they had been raised from 12 per cent. when the silver purchase programme began. In order to raise the ratio to one-third, the express objective of American policy, an additional 908 million ounces would have to be acquired, unless the amount of the gold reserves should alter. The gold reserves themselves, however, increased by no less than 1,887 million dollars in the course of 1935, and there were as yet no signs that this trend was likely to be reversed; it was thus apparent that even the exchange of gold for silver on a scale commensurate with the needs of China and Mexico and other countries would not soon bring the American Treasury within sight of its goal.

IX

NATIONAL EFFORTS, 1933–5

(a) *The Beginning of Recovery*

IN the last days of 1932 the Union of South Africa, the *fons* if not the *origo* of the gold standard, suspended convertibility into gold and attached her currency to the pound sterling. A few days later her fellow Dominion, New Zealand, fixed the exchange rate on London at 125 in place of 110 per cent. The prospect of a world war of currency depreciation would have seemed even more certain had it been then foreseen that before the year was out the United States dollar would have fallen to less than two-thirds of its former parity. Yet after the fall of the dollar there was no further notable essay in exchange depreciation, beyond the decision of Argentina in December to let the peso find its own level; and at the end of the year all the remaining gold standard countries stood stoutly by their determination to maintain convertibility at the existing parities.

Nevertheless, the disorganization of international exchanges, which the World Economic Conference so flagrantly failed to remedy, had meanwhile borne fruit in a continued reduction of world trade and in still more restrictions on international debt payments. The renewed depression of gold prices was at once cause and effect of this thinning of international commerce. The difficulties of debtor countries were, if anything, greater at the end of 1933 than at its beginning.[1]

[1] In March 1934 the Financial Secretary to the Treasury stated in answer to questions in the House of Commons that since the 1st January 1930 the following countries had failed to pay the full contractual interest on governmental loans issued by them in the London market: Brazil (Federal Government and States), Bulgaria, Chile, China (except certain loans paid in full), Colombia, Costa Rica, Ecuador, Germany (Länder), Greece, Hungary, Mexico, Paraguay, Peru, Rumania, Russia (presumably pre-revolutionary loans), Salvador, Uruguay, Turkey, and Yugoslavia. The above list comprised Governments only, and excluded provinces and municipalities. Governments which had suspended sinking funds, but had continued to pay the full contractual interest, were not included. The following countries, on the other hand, had met all their contractual obligations to British creditors on governmental loans issued in the London market: Argentina, Austria, Belgium, Cuba,

The only relief to the tale of default in 1933 was the resumption of payments on Government debt by Austria, after she had received her new international guaranteed loan.

In spite of these troubles, the bogged economic system still kept under its feet the firmer ground that it had begun to find in 1932. The process of liquidating international debt went on, and debtors were afforded relief by the depreciation of the pound and the dollar, in which many of their obligations were expressed. Money remained cheap in the chief monetary centres. The United States returned swiftly to easy money conditions after the restrictions of the panic period. The Bank of England rate remained at 2 per cent. throughout 1933, the Bank of France rate at $2\frac{1}{2}$ per cent., and the Reichsbank rate at 4 per cent. The Bank of Italy reduced its rate in the course of the year from 5 to 3 per cent. This was in preparation for a large-scale conversion of Government loans, which was successfully carried through in February 1934. Several other Governments took the opportunity presented by easy monetary conditions to convert their obligations to a lower interest basis, and many commercial firms did likewise. Bond prices on the London market, already high, rose by a further 5 per cent. in the course of the year. In Germany, where they were low, the index rose by over 10 per cent. In the United States, on the other hand, the bond market was a little weaker at the end than at the beginning of 1933, and in France it was decidedly weaker.

Still greater contrasts were shown among the indices of the prices of common stocks. In the United States, between January and December, there was a net rise of 43 per cent., in Great Britain a net rise of 11 per cent., and in Germany a net rise of 4 per cent.; whereas in France the index fell by 6 per cent. Even in France, however, there had been an appreciable

Czechoslovakia, Denmark, Egypt (full service paid in sterling), Estonia, Finland, France, Honduras, Italy, Iceland, Japan, Netherlands, Norway, Persia, Poland, Portugal, Siam, Spain, Sweden, Switzerland, and Venezuela. The Minister added that Austria had been for a time in arrear with payments in respect of pre-war Austro-Hungarian debts, but that the arrears had been made good. Guatemala and Nicaragua had suspended sinking funds by arrangement, but were not otherwise in default. The statement, of course, referred only to foreign countries; had the British self-governing Dominions been included, the picture would have been still more favourable.

increase of the volume of production, especially during the American boom of the summer months.

Nothing was more typical of 1933 than this divergence of national economic tendencies. Reliance upon national self-help for economic recovery, previously regarded as merely necessary in default of any better means, became almost an item of faith after the petering out of the World Economic Conference. Some European observers had hoped that with the Democrats in power, and with the dollar released from the chains of gold, the United States might choose a more internationalist commercial and financial policy. Mr. Cordell Hull, the Secretary of State, was himself a confirmed internationalist, and he was supported in the Cabinet by Mr. Wallace, the Secretary of Agriculture, who lost no opportunity of instructing his fellow citizens in the consequences of a nationalist policy. If, he said in effect, the United States were to abandon world markets for her primary products, then 40 or 50 million acres of her land would have to go permanently out of production; but if that conclusion were unpalatable, and she wished to sell her surplus of primary products abroad, then she must be prepared to buy the goods that other countries produced. It was on Mr. Hull's initiative that the economic committee of the Pan-American Conference at Montevideo in December resolved that conventions should be negotiated for abolishing import and export prohibitions and restrictions, and that all trade agreements should include an unconditional and unrestricted most-favoured-nation clause. In March 1934, the President asked of Congress powers to vary customs duties for the purpose of reaching commercial agreements with other countries, and thus initiated the Reciprocal Trade Agreements programme which was to play such a prominent part in the external economic policy of the United States in later years. Yet in 1933 itself there was little practical mitigation, and much definite aggravation, of American economic nationalism.

The other chief creditor country, Great Britain, while staunchly maintaining her new protectionism, concluded a series of commercial agreements[1] which effected a certain

[1] With Argentina, Denmark, Estonia, Germany, Norway, Latvia, and Sweden.

small downward modification of tariff barriers. On the whole, however, she too was unmistakably pursuing a policy of self-help, by way of easy money behind a depreciated exchange, combined with protection and other stimuli for home industry and agriculture. After clearing the ground by balancing the budget at the second attempt in 1931, the British Government laid the foundations of cheap money and commercial confidence by converting War Loan to lower rates of interest in 1932. The governmental stimulus given to industry was not reflationary but protective. The quantitative restriction of imports of primary products into the United Kingdom might almost be taken as the funeral liturgy of the old economic régime, for her great creditor position had demanded the liberal import of raw produce from the developing countries. Her decision to restrict such purchases was thus a warning that in future she might be expected to lend far less abroad than hitherto.

Those being the policies of the creditors, it was scarcely to be hoped that the debtor countries would relax their restrictions on trade. Even within the British Commonwealth the application of the Ottawa Agreements proved slow and laborious. Germany, the greatest industrial debtor country, continued to restrict imports by tariffs, quotas, and exchange control. In Germany and other countries practising exchange regulation the gold standard was of course only a figment. In France, on the other hand, the standard was fully maintained, though it required the aid both of relatively high interest rates and of further import restrictions. The result of the latter was to reduce France's imports of foodstuffs and manufactured goods by 12 per cent.; but her imports of raw materials increased, while her exports fell in value, so that on balance her trade deficit, at 9,992 million francs, was little less than in 1932. Through several changes of Government she upheld her policy of obtaining fiscal liberty by the abrogation or revision of tariff agreements, meanwhile checking her imports by means of quotas. At the beginning of 1934 this policy had brought her into diplomatic and economic conflict with several other countries, including Great Britain and Germany.

The net result of growing economic nationalism was a

continued stagnation of world trade. Yet the policy of self-help was by no means entirely a failure. Stable political conditions, cheap money, and protection, both by tariffs or quotas and by the low-valued pound, promoted in Great Britain a substantially higher volume of production and employment. This was accompanied, moreover, by a rise of 10 per cent. in the value of retained imports of raw materials. Still more important for the rest of the world was the industrial revival in the United States, which was naturally reflected in her foreign trade returns. In the second half of 1933 imports were 50 per cent. higher, and exports 30 per cent. higher, than in the second half of 1932. These calculations, of course, are made in dollars, which had been worth on the average 48 per cent. more in gold in 1932 than in the second half of 1933.

The divergent course of economic development in different countries became even more pronounced in the following two years. One day at the end of 1934 the news included two important items concerning the financial and economic situation of Europe. First, Italy had adopted measures for the mobilization of Italian investments abroad, in defence of the lira; second, the Austrian Standstill Agreement was to lapse, most of the credits it covered having been already repaid, and normal financial relations having been restored with the outside world. The contrast was highly noteworthy as a sign of the economic times. On the one hand, Italy had pursued, with the coercive thoroughness of the corporative state, a course of deflation designed to adjust her economy to the fall in world prices. On the other hand, Austria had been struck an early and numbing blow in the Credit-Anstalt crisis of 1931; she had been forced into technical default on her League loan; and she had undergone political turmoil, economic reprisals, and grave external menaces. Yet it was Austria and not Italy who was releasing her economy from 'crisis' controls, Italy and not Austria who was taking stern measures to defend her currency against an insidious weakness.

Contrasts as striking could be drawn elsewhere. In this period the countries of the world might be said to form two groups: those whose internal economic activity was being stimulated by an expansionist monetary policy behind a

depreciated exchange, and those which were forced to adopt a contractionist policy in order to defend themselves against the depreciated currencies of their customers and their commercial rivals. It seems worth while inquiring on what theoretical basis the contrast between the experience of these two groups may be explained. It is an axiom of economic theory that no country can make itself wealthy at the expense of others; further, that the competitive advantage given by currency depreciation wears off comparatively quickly, as internal costs adjust themselves to the new exchange rate. These propositions the events of the early recovery period appeared to contradict.

The contradiction, however, was to a large degree superficial. A part of the exchange advantage secured by the countries that forsook the gold standard was indeed nullified by relative movements of internal prices. Between August 1931 and August 1934 the value of sterling in terms of French francs fell by over 38 per cent. Had this been the measure of Great Britain's gain in competitive power in international trade, then France's handicap would have been almost insupportable. Meanwhile, however, the index of wholesale prices of industrial products in Great Britain had risen by 8 per cent., while the corresponding index in France had fallen by 22 per cent. On this reckoning, Great Britain's competitive power was enhanced to the tune of no more than 15 per cent. of former prices. This might be taken as the measure of the previous over-valuation of the pound, and if this were correct then the net result would have been to put France and Great Britain on an equal footing.

The calculation, however, conceals a further important fact. Just as, when wholesale prices fall, retail prices lag behind, so when wholesale prices begin to mount again retail prices rise more slowly and may even go on falling for a time. Thus in the same period (August 1931 to August 1934), retail food prices in Great Britain actually fell by 4 per cent., against a 20 per cent. fall for retail food prices in France. There were special as well as general reasons for the contrast between the movements of these two sets of price indices. A great part of the food supplies of Great Britain was drawn from countries

(especially the British Dominions and Scandinavian countries) whose currencies had depreciated against gold in at least as great a degree as had sterling. Hence the mere fact of the fall of the pound did not serve automatically to increase their price. On the other hand, in the face of cheap imports from countries with depreciated exchanges, France had resorted to further measures of protection for her own agriculturalists, with a consequent strengthening effect upon internal prices. Had not Great Britain adopted certain similar protective measures for her home agriculture, the contrast might have been still more striking. The cost-of-living figures amplify the evidence of the retail price indices; for whereas between September 1931 and September 1934 the British index of the cost of living fell by 1½ per cent., in France the corresponding index fell by no more than 8 per cent. We may summarize these calculations thus: Great Britain's proportionate competitive advantage on the basis of exchange rates, 38 per cent.; corrected for movements of wholesale prices, 15 per cent.; corrected for movements of retail food prices, 25 per cent.; corrected for movements of the cost of living, 34 per cent.

Thus while in Great Britain the 'scissors' of wholesale prices and the cost of living were opened wider, in France they were forced together. Broadly, the former 'blade' might be regarded as a measure of the capacity of industry to pay wages, the latter 'blade' as a measure of the wage-level needed to maintain a given standard of life. Hence it was not surprising that whereas in 1934 unemployment diminished in Great Britain, while average wages increased, in France unemployment grew worse in spite of a steady pressure towards a reduction of wages.

Mass unemployment introduced a complication into the thesis that no country could gain in wealth at the expense of its neighbours. Possessing idle resources of man-power and capital equipment, a country could advance in prosperity, through a greater employment of those resources, without any increase of wealth—using 'wealth' in the sense of economic capacity, industrial efficiency, and ability to procure goods abroad. Indeed, such a country might increase its industrial turnover by dint of measures that actually diminished its

wealth in this sense. Furthermore, these measures might be of such a kind as to injure not merely the 'wealth' of foreign countries, but also their ability to find fuller employment for idle men and stagnant capital. Thus, although, for instance, an increase of tariff protection might mean a loss of exports equal to the cut in imports, capital expansion in the protected industries might well cause a decrease of unemployment and a secondary stimulus to the consumption-goods industries. Although the countries whose goods were thus excluded might adopt defensive measures in return, they might not be able similarly to readjust their internal economies.

Where the initial move was not a raising of tariffs but a fall of the exchange, no equivalent retort was possible. Exchange depreciation is essentially relative, and all currencies cannot simultaneously depreciate against each other. Moreover, in this case a further stimulative factor came to the aid of the depreciating country; for, being loosed from the restraints imposed on monetary policy by the need for preventing an outflow of gold, it could pursue a liberal credit policy on the foundation of reserves whose nominal value could be written up. It seems likely, indeed, that monetary expansion, being both cause and consequence of exchange depreciation, was of more account in the economic revival of the off-gold countries than was the enhancement of their international competitive power. In this fashion the facts may be reconciled with the theoretical axioms with which at first sight they seemed to conflict. In the pages that follow, the experience of several different groups of countries is examined, with special reference to the effect of relative exchange movements upon their economies.

(b) *The British Oversea Dominions*

In spite of the continued depression of prices for primary commodities, the overseas parts of the British Empire had achieved an appreciable measure of economic recovery by 1934. Their revival was intimately associated with the depreciation of sterling. When the pound left gold in 1931, Australia, New Zealand, and Canada were already off the gold standard in the vital sense that the export of gold, obtainable

for notes at par, was no longer being freely permitted. The Australian, New Zealand, Indian, and Irish Free State currencies naturally followed sterling. The Canadian dollar, attached to the economy of the United States by close commercial and financial ties, was left suspended between sterling and the United States dollar. Only the Union of South Africa resisted the depreciation against gold, partly out of a belief that anything which brought nearer a general abandonment of the gold standard would be against the ultimate interests of the Rand mining industry; and partly because, in Mr. Havenga's words, 'there is a grave risk in a small country like South Africa with a small population, where a small section can exert strong political pressure, that if you once slip your anchor it will be practically impossible to stop what we call inflation'. Under the régime of the gold standard, however, South Africa's economic difficulties multiplied, and in December 1932 a political crisis caused by Mr. Tielman Roos's campaign for the abandonment of gold was followed by the suspension of convertibility and the virtual attachment of South Africa's currency to sterling at the old pound-for-pound rate.

The fall of their currencies against gold, and in some cases against sterling, helped the Dominions in several direct and indirect ways. To the extent that the market for the products which they exported was a world market and not a 'sterling area' market, and to the extent that world prices were not themselves depressed by deflationary measures following the fall of sterling and associated currencies, the Dominions obtained higher prices for their exports in terms of their own currencies. Their local monetary systems were freed from the restraints imposed by the need for protecting metallic reserves. Their manufacturing industries obtained a measure of protection against imports. Furthermore, each of them was a producer of gold on an appreciable scale—the one commodity whose price in their own currencies would assuredly be multiplied by the full measure of the depreciation. The table on p. 276 shows the growth of their gold production after 1930. These figures must be read in the light of two very important facts. First, the policy of the Rand mining industry, with the active concurrence of the Union Government, was to lower

Gold Production

(In thousands of fine ounces)

	Canada	*Australia*	*New Zealand*	*S. Africa*	*India*
Average 1928–30 .	1,974	451	121	10,494	356
1931 . . .	2,694	595	130	10,878	330
1932 . . .	3,044	714	166	11,559	330
1933 . . .	2,949	830	162	11,014	335
1934 . . .	2,964	878	160	10,480	321
1935 . . .	3,285	889	165	10,774	326

the average grade of ore mined as the price of gold rose. The effect of this was to stabilize the volume of output—even to restrict it—and to prevent the exhaustion of the underground assets of the mines. Second, with every fall of British Empire currencies against those still on the gold standard, the price of gold expressed in the former rose proportionately. Thus the average price of gold in London during 1934 was 137*s.* 8*d.* per fine ounce, compared with a gold-standard price of 84*s.* 11*d.* per fine ounce. The result of this rise of price for the Dominions may be illustrated from the experience of Canada, whose output of gold fell from 3,044,000 fine ounces in 1932 to 2,964,000 fine ounces in 1934, whereas the value of the output rose from $63 millions to $102 millions. Other British countries besides the Dominions and India shared in the prosperity of gold mining. Output in Southern Rhodesia rose from 532,000 fine ounces in 1931 to 691,000 fine ounces in 1934; in the Gold Coast from 262,000 fine ounces to 324,000 fine ounces in the same period; and in New Guinea from 44,000 fine ounces to 160,000 fine ounces.

India was affected less by the value of new production than by the withdrawal of gold from hoards. In the three and a half years ended March 1935 the total value of gold shipments from India was no less than £173 millions. But for these exports, India's task of squaring her external balance of payments would have been insuperable without drastic deflation and a great curtailment of imports, or else a relapse of the rupee from the sterling standard.

In some measure the increased value of gold helped every

one of the oversea Dominions to balance its external accounts. After 1931, however, the external balance of payments ceased to be their foremost economic problem. Up to 1929–30 Australia had an excess of imports over exports, but in 1930–1, on a greatly reduced volume of trade, she achieved an export surplus of £28 millions sterling, and by the following year this had been raised to over £40 millions sterling—a figure amply sufficient for the service of her overseas debt. New Zealand had a still more striking experience. Between 1929–30 and 1933–4 her imports were cut from £49 millions (N.Z. currency) to £27 millions, while her exports were raised from £47 millions to £49 millions. The result was the accumulation of large excess balances in sterling, after all debt charges had been met. The Dominions, as a group, had righted their trade balances by exchange depreciation, by higher general tariffs and special surcharges on imports (especially in Canada under the 'Canada First' tariff, and in Australia under the 'Scullin' tariff), by bounties on exports (especially in Australia and South Africa), and by internal deflationary measures designed to diminish their costs of production and to increase their world competitive capacity. They were also helped by the improvement of the price of certain primary products (most notably wool) in 1933 and 1934.

In the second phase of their course through the depression, their main problem was not external but internal—to cope with the impoverishment of primary producers and with heavy unemployment. Broadly speaking, the task was one of monetary expansion, consistently with the maintenance of exchange stability and the solvency of Governments.

Australia.

The efforts of Australia in this direction were so remarkable that they must be treated at some length. In January 1931 the Premiers' Conference—a non-statutory body for co-operation between states and Commonwealth in financial and other matters—found itself faced with a very grave financial and economic position. A deflationist report from a committee of Treasury officers was countered by Mr. Lang, the Premier of New South Wales, with a proposal that internal interest on

Government bonds should be reduced to 3 per cent., that oversea interest payments should be withheld pending agreement upon a similar reduction, and that the gold standard (already in suspense) should be supplanted by 'currency based on the wealth of Australia'. The majority of the Conference, however, preferred a resolution in favour of balancing budgets in three years' time, reducing salaries and wages in accordance with the fall in the cost of living, taxing interest on Government bonds at the source, and putting on the banks the responsibility for reducing interest rates.

When the Premiers' Conference was convened again in the following May it had before it a report of a mixed committee of economists and Treasury officers, under the chairmanship of Professor D. B. Copland. This report formed the basis of the 'Premiers' Plan', which was adopted unanimously by the Conference, with the concurrence of the Leader of the Opposition in the Commonwealth Parliament, on the 10th June 1931. The plan, which was adopted—so its preamble ran—as an indivisible whole, embraced the following measures: a reduction of 20 per cent. in all adjustable Government expenditure, including all wages, salaries, and pensions; the conversion of internal debts of the Governments on the basis of a reduction of interest by 22½ per cent.; the securing of additional revenue by taxation; a reduction of bank and savings-bank rates of interest on deposits and advances; and legislative relief for mortgagors.

The part of the plan that aroused the greatest controversy was the conversion of internal debt to a lower rate of interest. As a result of a vigorous publicity campaign the holders of over £510 millions out of a total internal public debt of £558 millions signified their consent to a conversion loan reducing rates of interest by 22½ per cent, and a further £31 millions were converted automatically, under the terms of the governing Act, in the absence of notification one way or the other. Holders of less than £17 millions signified their dissent. The percentage of voluntary acceptance being so high, the Governments felt justified in applying compulsion in respect of the residue, provision being made for the cash redemption of securities held by necessitous persons. How far the likelihood of eventual

compulsion induced the majority of holders to seek the satisfaction of voluntary self-sacrifice while there was yet time it is impossible to say. One very powerful motive was undoubtedly the knowledge that a dangerous resentment would be aroused by a cut in wages unaccompanied by an equivalent curtailment of *rentiers'* incomes. The conversion was completed in September 1931.

Unlike his fellow within the Commonwealth, the external holder of Australian bonds continued to receive his full interest, a fact which particularly incensed Mr. Lang. Early in February 1932 he announced that New South Wales was about to default on interest due on its loans in London and New York, and in Australia too. The Commonwealth Government, after a short delay, met the payments due, and in the interests of Australian credit they proceeded to pass into law a measure designed to remove all doubts about Commonwealth liability for state debts which had been pooled under the Financial Agreement of 1928. New South Wales being still recalcitrant, another measure, the Financial Agreements Enforcement Act, was passed giving the Commonwealth drastic powers to attach state revenues and other moneys in the event of a state default on moneys due under the Agreement. In May, Mr. Lang was dismissed from the premiership by the State Governor on the ground that he had given illegal orders in defiance of Commonwealth authority, and in the subsequent elections he suffered a signal defeat.

The conversion of internal debt was calculated to save the Governments £6½ millions per annum—an essential part of the budgetary adjustments agreed upon in the plan. The aggregate deficits of states and Commonwealth had been £25 millions in 1930–1, and were estimated at £41 millions for 1931–2. The economies and fresh taxation accepted by the Premiers' Conference were estimated to reduce the latter figure to £13 millions. This result would actually have been achieved in the aggregate, but for the special difficulties of New South Wales, whose deficit rose to £14 millions against a Premiers' Plan estimate of £6 millions. By 1932–3 the New South Wales deficit had been cut to £4 millions, and thanks to a considerable surplus on the Commonwealth Budget the

combined accounts of all Australian Governments showed a deficit of only £5 millions, which was more than covered by sinking-fund payments. At that stage, however, there began to appear a grave contrast between the fiscal capabilities of the states and those of the Commonwealth. In 1933–4 the states could do no better than incur a joint deficit of £7 millions, whereas the Commonwealth was able to remit taxation and increase expenditure, to an estimated total of £9 millions, and yet achieve a surplus of over £1 million.

The financing of these state deficits was beginning to prove a matter of real difficulty. The authors of the Premiers' Plan had acknowledged that the gap in Government accounts would have to be covered for a while by borrowing, a process which might have been expected to keep up rates of interest in the Commonwealth. Nevertheless, they had pressed for a general reduction of interest rates. Curiously, these two measures were in a certain degree complementary, rather than conflicting; for, in the absence of an organized money market, the trading banks had been compelled to keep an abnormally high proportion of their assets in the form of cash, whereas if they could procure Treasury bills from the Commonwealth Bank they could replace a certain amount of their idle money with interest-bearing assets, and thus reduce their charges to their customers.

Before long, however, the Board of the Commonwealth Bank became uneasy about the steady growth of the volume of Treasury bills, and pressed for its reduction by means of funding as well as of stricter budgeting. At the beginning of the depression period the public works programmes of the Governments, which were not covered by their ordinary budgets, had been financed by Treasury bills, but in April 1932 a long-term loan of £2,400,000 was raised for this purpose, and in October 1933 it was decided, under pressure from the Bank, to issue a loan of £8 millions for unemployment relief works and for the funding of Treasury bills. In the following February the Loan Council agreed with the Commonwealth Bank that all future requirements for loan programmes should be raised on the open market. Conservative finance was carried a step farther in June 1934, when the Bank Board agreed to discount Treasury

bills for the financing of prospective deficits during 1934-5 only on condition that half the amount should be funded within six months and the remainder within twelve months. The Bank further declared that in future it would not finance deficits even temporarily by Treasury bills, except to the extent of the seasonal lag in revenue. One effect of this pressure from the Commonwealth Bank was to range Governments of different political complexions in common resistance to the Bank's policy.

The necessary governmental economies depended upon substantial cuts in wages and pensions, which in turn implied a general reduction of the money-wage standard throughout the country, since a high proportion of the labour force was in the employment of the various Governments. In January 1931 the Commonwealth Court of Arbitration, after surveying the whole economic position, had awarded a 10 per cent. reduction in all railway wages which were the subject of the case before them, and this judgement was followed by others, making the same reduction in practically all wages and salaries which were determined by Federal award. Wages under the jurisdiction of state arbitration courts were gradually brought into line, except in Queensland and Western Australia. This 10 per cent. cut was imposed over and above the automatic reductions in accordance with the fall in the cost of living, and at its lowest point at the beginning of 1933 the nominal basic wage was 30 per cent. below the level of 1926. In May 1933, however, the Commonwealth Court gave a judgement which had the effect of restoring over one-half of the 10 per cent. cut, and in April 1934 this increase was further consolidated. The comparative flexibility of wage-scales under a system of statutory awards, in a period of general depression, was one of the most interesting aspects of Australian economic history in these years. In many trades, the real wages of those in employment were substantially less after 1931 than they had been before the economic crisis. That was not true of many other countries, and certainly not of Great Britain.

The Australian specific plan for meeting the crisis thus included a considerable measure of deflationary practice, combined with a certain 'expansionism'. The latter element was

to be found in the financing of budgetary deficits and public works by means of Treasury bills, which in turn helped the banks to pursue an easier credit policy, and in the maintenance of a depreciated rate of exchange. The premium on English sterling had been pegged at 8½ per cent. from October 1930 to January 1931. At the latter date, on the initiative of the Bank of New South Wales (throughout this period a protagonist of 'reflationary' policy), it was allowed to move up to 30 per cent., at which rate it was held by agreement among the commercial banks. The Premiers' Plan deprecated 'premature efforts to force down' the exchange rate until markets for Australian exports were once more expanding. In the following December, the Commonwealth Bank Board resolved to take responsibility for the regulation of sterling exchange, and fixed the rate, in accordance with the open market trend, at £125 for every £100 sterling.

Meanwhile the facts of Australia's external balance of trade, the prime determinant of the rate of exchange, had altered remarkably. In 1928–9[1] her imports and exports (including newly mined gold) almost balanced. In the following year exports had slumped by £40 millions,[2] and there was a debit of over £30 millions on the trade accounts. Moreover, imports of capital had ceased, and interest had to be paid on previous borrowings. Nearly £25 millions of gold had to be dispatched from the monetary reserves, and sterling balances were also depleted. Then came the 'Scullin' tariff and surcharges and the fall in the exchange value of the Australian pound; imports in two years were cut by two-thirds, and in 1931–2 there was an export balance of £35 millions in commodity trade (including new gold). Imports then began to rise again, thanks partly to a somewhat more liberal tariff policy, partly to increased purchasing power in Australia; but for the time being the strain had been diverted from the balance of payments.

In this external adjustment Australia was assisted by a succession of good years, as far as climatic conditions were concerned, and later by the rise in wool prices in 1933. But generally speaking the initial stages of her recovery were

[1] Years ended 30th June. [2] Values in sterling.

accomplished in spite of continued low prices for her principal products. The restriction of production in order to raise prices was altogether foreign to her economic programme. In this, as in other respects, her measures of recovery contrasted with those of the United States, with whom she was often compared on the strength of certain superficial resemblances. The New Deal was based in large part upon the doctrine of high wages, whereas the Premiers' Plan had as its central feature the reduction of wage rates. It was primarily a plan for balancing budgets; any reflationary effects were incidental, and to a large extent unintended.

New Zealand.

New Zealand's problem in the depression was in many ways similar to that of Australia. Their principal exports were identical (except wheat, of which New Zealand had long ceased to be an exporter). Both had borrowed heavily in London, and both were faced with a sudden cessation of international lending. In other respects, however, there were important differences. New Zealand had already a considerable surplus of exports over imports in 1929, and in no subsequent calendar year during the depression did she incur a deficit on her commodity trade. Her protective tariff was much lower than that of Australia, and her economic capacity for factory production much less, chiefly by reason of her much smaller population. Her budgetary problem was much less severe—in 1929-30 she achieved a small surplus—nor was it complicated by a federal system.

The two most vital elements in New Zealand's problem were unemployment and the fall in the incomes of the rural community. Unemployment did not become serious until 1931, but it then rose with startling swiftness and it continued to rise, on the whole, for the next two years. Special taxation was imposed for the relief of unemployment, and an Unemployment Board was set up to administer schemes of relief. At the end of September 1933 the Board was providing full-time employment for 23,000 men, and part-time employment for 52,000. New Zealand's population at this time was less than 1,500,000, of whom only some 70,000 were recorded as

engaged in factory industry. On a crude ratio of populations, the equivalent figures for Great Britain would have been roughly 670,000 placed in full employment under the relief schemes, and 1,500,000 given part-time work.

Only some 6 per cent. of the registered unemployed were farm hands, but the depression of the farming industry was doubtless the chief originating cause of the unemployment, largely because it put an end to expenditure of borrowed money on public capital works, like railways, roads, and bridges, designed in the interests of the rural community. Between 1928–9 and 1930–1 New Zealand's exports of butter and cheese rose from 3,228,000 cwt. to 3,598,000 cwt., but fell in value from £19,635,000 to £15,145,000. Her exports of frozen meat rose from 3,601,000 cwt. to 3,906,000 cwt., but fell in value from £10,274,000 to £9,102,000. These figures must be considered satisfactory beside those for wool; New Zealand exported slightly less wool (649,000 bales against 688,000) in 1930–1 than in 1928–9, at a total price nearly £10 millions lower (£6,195,000, against £15,923,000). Her total exports fell in that period from £56,111,000 to £36,944,000, and her total imports from £46,479,000 to £33,260,000. Whereas, however, her exports were stabilized for two years at approximately the same figure, her imports went on falling, and in the year ending the 30th June 1933 she had recovered an export surplus of over £15 millions. One result of this adjustment was that a further depreciation of the exchange (it was already at a discount of 9 per cent. on London), which would have tended to raise export prices, was not forced upon her by exchange necessity. As a deliberate item of policy it had considerable disadvantages. It might be unfavourably regarded by opinion in Great Britain as a subterfuge for increasing the height of protection. It would raise the local cost of external debt service. It was likely to cause an accumulation of excess sterling balances. Hence it was strongly opposed by the majority of the New Zealand banks, which were unwilling to tie up their assets in London, where so little could be earned upon them. Thus the controversy raged for some months. In the end the primary producing interests gained the day, and the exchange rate was altered

in January 1933 to 25 per cent. premium on sterling, the same rate as was being maintained by Australia. The Government, in taking this decision (which involved the resignation of Mr. Downie Stewart, the Minister of Finance), were obliged to guarantee that they would take over from the banks their excess sterling balances in exchange for Treasury bills. By August 1934, when these sterling reserves were handed over to the new central bank, they totalled £24½ millions (New Zealand currency).

The exchange controversy, and the results in the field of public finance, undoubtedly hastened the creation of a reserve bank, which took place at the end of November 1933. The gold held by the trading banks was to be compulsorily acquired at mint par value in New Zealand currency, and any eventual profit was to accrue to the Government. The Reserve Bank took over the accumulated surplus of sterling as part of its reserves, and it assumed the liability to acquire from the banks, in exchange for its own notes, any future excess sterling balances. This seemed to foreshadow a certain measure of inflation, since the continuance of a net credit on the balance of payments would result in a steady accretion of notes to the trading banks' reserves. Unless, indeed, the exchange were to move back, or the trade balance to become much more adverse to New Zealand, some internal inflation seemed necessary in order to correct the anomaly of an excessive export surplus coupled with a stagnant internal economy.

New Zealand thus presented a picture of a country obtaining in its external trade the full advantages that might be expected to accrue from exchange depreciation—indeed on mercantilist principles flourishing exceedingly—yet remaining internally in the dumps through inability to expand purchasing power and employment. This was an important factor determining her attitude towards proposals from the United Kingdom to raise the price of certain of her exports (meat and dairy products) by means of restriction of supply. In respect of internal activity and the volume of employment, an expanded production, even at a reduced price, suited New Zealand's book better at this time than greater total receipts for a smaller output. On the other hand, low prices for primary commodities were

causing great and growing difficulties in the treatment of agricultural indebtedness, which remained one of the most obdurate of New Zealand's internal economic problems.

Canada.

Two outstanding facts differentiated the economic career of Canada from that of the Pacific Dominions during the depression. The first was her close financial relationship with her neighbour, the United States, and the second was the greater degree of her industrial development. Other characteristics of Canada's economic experience included her peculiar dependence upon wheat exports and the extraordinary importance of her transport system in her whole economy. These points may be illustrated by a few summary figures. In 1930, out of Canada's total exports of \$1,120 millions, practically \$500 millions went to the United States; and out of total imports of \$1,248 millions, some \$868 millions came from the United States. Even in that year, wheat accounted for nearly 20 per cent. of all Canada's exports, and in 1929 the proportion had been no less than 31½ per cent. In 1929 the net value of Canadian manufacturing production approached \$2,000 millions, and its gross value was more than double that figure. The total value of all field crops was less than \$1,000 millions. Moreover, whereas two years later the value of the field crops had fallen by nearly 55 per cent., the net value of manufacturing production had fallen by only 26 per cent. The importance of the railways may be judged from the fact that in 1929 the gross earnings of steam railways alone were well over one-quarter of the value of the net product of the whole of Canada's manufacturing industry.

The American boom of 1927-9 greatly inflated costs, prices, and indebtedness in Canada, and when it collapsed the recession was correspondingly severe. Perhaps the most desperately situated section were the wheat farmers, especially in the southern parts of the prairie provinces; for the low price of wheat was accompanied by a succession of droughty years which to many brought complete destitution. One result was a drift of population to the towns, which gravely intensified the problem of unemployment. Another was the development

of mixed farming, and a corresponding trend of population to the areas suitable for such cultivation. A more general feature of the early depression years in the farming districts was a very great reduction in working costs.

The money income of the Canadian farming community continued to fall until the end of 1931, when it had shrunk to only 48 per cent. of the 1926 base figure. For a year it remained more or less stabilized at this level, then it fell sharply again, and there was no substantial recovery until the United States dollar depreciated against gold in 1933. By the third quarter of 1934 the money income of Canadian farmers was once more approaching 48 per cent. of the 1926 base, and owing to the fall in prices its purchasing power was 67½ per cent. of what it had been in 1926.

Whatever may have been the secondary effects of the depreciation of the United States dollar, its primary effects on the Canadian economy were unmistakably favourable. When Great Britain went off the gold standard in 1931, the Canadian dollar was already off gold, and was at a substantial discount on New York. After September 1931 it remained poised between the two currencies. The weightiest objection to allowing it to fall to parity with sterling was the enormous indebtedness of Canadian firms, local bodies, and Governments to United States investors; for the service of these loans had to be paid in United States currency, and would therefore rise in cost proportionately with any fall in the Canadian dollar. Total investments in Canada held by United States citizens and corporations were reckoned at $4,107 millions at the 1st January 1931. Although a large proportion was payable in Canadian currency or took the form of share investment, in respect of this external debt the depreciation of the United States dollar was a boon to Canada. Her currency appreciated against that of her neighbour, while falling against the pound and still more against gold bloc currencies. At the end of 1934 the Canadian dollar was at a small premium on New York and at a small discount on its pre-1931 parity with sterling. The rise of Canada's imports between 1933 and 1934 from $401 millions to $513 millions, and of her exports from $532 millions to $653 millions, was

due in large part to the depreciation of the exchange, but another important cause was the improvement of trade conditions in the United States.

Political as well as economic developments across the border had their effect on Canada's affairs. It was not to be expected that the example of N.I.R.A. and of the Agricultural Adjustment Administration would count for nothing in Canadian politics. Early in 1934 Mr. Stevens, then Minister of Trade and Commerce, and later the founder of the 'Reconstruction Party', was made chairman of a select committee (afterwards transformed into a Royal Commission) to investigate 'price spreads' and business practices. Some of the evidence brought before it seemed to confirm charges of sweating and unfair competition, with the result that strong agitation arose for the regulation of Canadian trade and industry on the N.I.R.A. model.

The Stevens Commission had been empowered to consider the marketing of live stock and other primary products, but in March 1934 their possible recommendations on this section of their agenda were partially forestalled by the introduction of the Natural Products Marketing Bill, providing for the establishment of federal, provincial, and local marketing boards to control the trade in primary products of all kinds except minerals. The initiation of such a scheme of marketing control would lie with the industry concerned, but once the Government were satisfied that the petitioners were sufficiently representative they could enforce a compulsory scheme. The central marketing board could fix standards and grades, control the export and inter-provincial sale of the product concerned, and regulate the importation of any competitive product. After investigation by a special committee it could fix fair price spreads to cover the gap between the return to the producer and the cost to the consumer.

In January 1935 the Canadian Prime Minister, Mr. R. B. Bennett, startled his fellow citizens by a series of broadcast talks in which he advocated a thorough-going reform of the economic system. In this 'New Deal' programme the example of President Roosevelt was plainly to be traced. The reform required, said Mr. Bennett bluntly, 'means Government

control and regulation. It means the end of *laisser-faire*.' After referring to the steps already taken by the Government in this direction—mortgage relief, the provision of credit for farmers, the Natural Products Marketing Act, the creation of the new central bank—Mr. Bennett promised to establish unemployment insurance, a new old-age pension system, sickness and accident insurance, minimum wages and maximum working hours for the whole Dominion, a Ministry of Communications, and a National Economic Council. He also promised that his Government would implement the report of the Royal Commission on price spreads and business practices.

The Commission's report was published on the 9th April 1935. It was a remarkable document, not merely by reason of its practical recommendations, but also by reason of the theoretical economic analysis on which the majority on the Commission based their conclusions. 'Concentration in production and distribution, resulting from the development of the corporation and the large-scale business unit', had made the actual competitive scene progressively less like the simple competition of the *laisser-faire* economists. In these circumstances, price no longer adjusted itself to supply and demand, but the dominant producers fixed their price and adjusted their production to it. The price might be set anywhere within a 'zone of indeterminateness', according to relative bargaining strengths, while unfair trade practices, especially price discrimination, became rife. Moreover, the bargaining advantage of strong organized groups might lead to the exploitation of the weak and unorganized. Finally, 'all these circumstances unbalance modern economic society in the sense that not all of its parts adjust themselves at the same speed or in the same degree to any influence that makes itself felt at any one point'. Here the Commissioners inserted a diagram showing that while between 1929 and 1933 the prices of agricultural products in Canada had fallen by 49·4 per cent., agricultural output had actually increased by 4·0 per cent.; whereas the production of agricultural implements had been cut by no less than 86·4 per cent., against a fall of only 6·4 per cent. in the prices received by the industry.

The majority report then proceeded to a detailed study

of conditions affecting manufacturing industry, labour and wages, primary production, distribution, and consumption, especially in the following important Canadian industries: agricultural implements, baking, canning, can manufacturing, clothing and needle trades, fertilizer manufacturing, fishing, flour-milling, furniture manufacturing, live stock and meat-packing, rubber goods, textiles, and tobacco. Its general recommendations were contained in a chapter headed 'The Problem of State Control'.

'We are convinced [wrote the Commissioners] that certain forms of intervention are likely to be less expensive than the waste of goods and of life that the collapse of the economic system, even if it retains its recuperative power, periodically occasions. We believe, however, that the loss of political freedom and individual liberty would be too high a price to pay for the automatically planned economy of state capitalism, fascism, or communism (even if they should achieve their avowed economic goals), and we are confident that it is still within the capacity of the Anglo-Saxon nations to work out a system of social control in which freedom can be preserved without economic paralysis, and in which, without dictatorship, production can be made less unstable and the distribution of wealth and income less unequal and less inequitable.'

The main recommendation was the creation of a Federal Trade and Industry Commission, consisting of five members appointed by the Governor-General in Council. Its duty would be to protect the interests of every economic class or group, and in particular to administer rigorously the Combines Act, to regulate monopoly where it was agreed by the Government that competition could not or should not be restored, and to sanction and supervise agreements within a trade or industry where it was agreed by the Government that competition had become wasteful or demoralizing. The scope of the Combines Act should be extended so as to cover all monopolistic or semi-monopolistic practice. The Commission should have power to ban 'unfair trade practices', including discriminatory discounts, rebates and allowances, territorial price discrimination, and predatory price-cutting. Among other functions, it should conduct the regulation of new security

issues for the protection of the investor. The majority on the Commission made a number of proposals for the tightening up of the Dominion Companies Act, with the general aim of putting the managers and directors in a trustee capacity with respect to all security-holders.

A further important series of recommendations was put forward in the field of labour conditions and wages. Dominion and provincial labour legislation should be more rigorously administered, notably by the appointment of a much greater number of inspectors. The provinces, within whose legislative field the most important parts of this subject-matter lay, were advised to consider the establishment of maximum hours of labour for men as well as women, and in the Commission's view the standard hours should not exceed forty-four per week. There was a pressing need for national uniformity in labour legislation. If it were found that the Federal Parliament was not constitutionally competent to pass uniform Dominion legislation in this field, then the British North America Act should be amended so as to enable this to be done. Pending the settlement of the constitutional question, an annual Dominion-Provincial Labour Conference should be called to consider means of bringing the different provincial laws into line, and also to procure the implementing of draft conventions passed by International Labour Conferences.

The majority report was signed by all the six Conservative members of the Commission and by the single representative of the Co-operative Commonwealth Federation (the Socialist third party in Canada). Three Liberal members also signed the report, but attached a memorandum of reservations on a number of points of detail, expressing their fears as to the spread of Government-sanctioned monopoly under the aegis of the proposed Federal Trade Commission. One member only, a Liberal, signed a dissenting report. In his view the proposed Commission would be 'meddlesome and mischievous'.

Not the least interesting of the Commission's recommendations was that of a Dominion-Provincial Conference to secure the implementing of International Labour Conventions. After the publication of their report, Mr. Bennett sought to use these draft conventions to get round the constitutional limitations

on Federal authority in the field of labour conditions, relying on the Dominion Parliament's power to implement international treaties. This claim was rejected by the Judicial Committee of the Privy Council in a series of decisions handed down in January 1937. Acts whose constitutionality had been challenged, dealing with a weekly rest in industry, minimum wages, and maximum hours of work, fell to the ground. The Judicial Committee also pronounced invalid the Natural Products Marketing Act and an Act establishing a Dominion scheme of unemployment insurance. Thus the whole framework of Canada's New Deal collapsed through constitutional incapacity. Later in 1937 the Canadian Government appointed a Royal Commission to consider the whole question of financial and constitutional relations between the Dominion and the provinces.

One important initial hindrance that the New Deal had to meet in the United States was not shared by the Dominion. Her banking system was sound, and the principal reform required—the establishment of a central bank—was accomplished without serious political or financial trouble. The Bill to incorporate the Bank of Canada was introduced on the 22nd February 1934, following the recommendation of a Royal Commission under the chairmanship of Lord Macmillan. It was on orthodox lines—the acquisition of gold from the banks at mint prices in depreciated currency being now regarded as orthodox policy.

Union of South Africa.

The story of South Africa in the depression is peculiar in that so much depended on the fortunes of the gold-mining industry. Apart from gold and diamonds, her total exports in 1929 totalled only £39,400,000, of which over £14½ millions was accounted for by wool. Other important items were maize, hides, fruit, sugar, and coal. By contrast, the diamonds exported were valued at over £12 millions, and the gold at over £45,300,000. The diamond industry suffered perhaps more than any other in the world from the slump in values and the reduction of purchasing power. Mining virtually ceased in South Africa, and the international diamond syndicate

occupied itself with selling small quantities from existing stocks. The export of diamonds from the Union fell to less than £2 millions in 1932. Meanwhile, other exports (excluding gold) had fallen in value by just over one-half, chiefly by reason of the fall in primary prices, but partly by reason of a reduced surplus of grain for export. Imports had been cut from £83,400,000 to £22,800,000—a remarkable feat of abstention. The farmers, in whose hands lay the balance of political strength, clamoured for aid, and subsidies to exports were given in various forms.

While other industries were suffering these wide fluctuations of prices and prosperity, the gold-mining industry of the Rand became rather more prosperous, on account of the steady price for its product and the reduction of its costs as other prices fell and technical progress advanced. Exports of gold from the Union of South Africa increased by nearly £2 millions between 1929 and 1932. It was largely because of the stability of the gold-mining industry that South Africa did not suffer any such severe fall of internal prices or increase of unemployment as might have been expected by comparison with other overseas Dominions, having regard to the fact that her currency was appreciated against sterling while theirs were depreciated (except Canada's). The index of employment for Whites in the population of the Union fell by 12 per cent. between 1929 and 1932, while wholesale prices fell by 21 per cent.

All this time South Africa remained on the gold standard, and was unable to hoist up her own price-level by hauling against the world price-level expressed in gold. In the last days of 1932, however, a political crisis was followed by the suspension of the gold standard, the formation of a Coalition Government, and the lowering of the Reserve Bank's discount rate from 5 to $3\frac{1}{2}$ per cent. By the end of 1934 the political coalition was well on the way towards consolidation in a new 'United' party. The South African pound, in terms of which sterling had averaged about $26\frac{1}{2}$ per cent. discount in 1932, very quickly returned to its former parity with London, and there it remained. Exports of gold rose to over £68 millions in 1933, and other exports were swollen in value by the rise of

prices expressed in South African currency. The Union also benefited considerably by the swift rise in the world price of wool that took place in that year. Imports rose rapidly, from £33 millions in 1932 to £66 millions in 1934, a movement by which United Kingdom export industries profited considerably. The great prosperity of the Rand expressed itself in all the main economic indices in the Union. By the middle of 1934 the volume of employment (white people only) exceeded its average level in the boom year 1929. The note issue of the Reserve Bank rose from £8,430,000 at the end of 1932 to £13,460,000 at the end of 1934. Even diamond exports, in response to a slight revival in world demand, improved appreciably in 1934, and early in the following year several diamond-mining concerns reopened their workings. One of the most striking indices was the total of building plans passed, which rose from £4 millions in 1932 to £13 millions two years later. This was higher than the annual total even in 1929, and such a stimulation of capital investment was bound, not only to provide a great deal of direct employment, but also to expand purchasing power and prices at second remove. By 1935 South Africa was well on the road to a general boom.

But she had important economic problems still to solve. Perhaps the most difficult was that of the relations between industry (especially mining) and agriculture in the economic and political structure of the Union. On the one hand, while the towns were flourishing, largely under the stimulus of gold-mining profits, the farmers were still afflicted by low prices and expanded output. On the other hand, while the farming industry was fiscally favoured by subsidies and other means, there were many to complain of the high taxation imposed on the mines. The large and 'unearned' profits accruing to the Rand mining companies as a result of the depreciation of the South African pound naturally excited the envy of other sections of the community, and were regarded by the Minister of Finance as a proper object of special taxation. In the year 1934 the South African Government drew from the gold-mining companies of the Transvaal no less than £13,200,000 in total revenue, including £5 millions from leases, £4½ millions from income tax, and £3,700,000 from excess-profits

duty. The working profits from which these sums were furnished totalled £32,400,000, out of which dividends of £15,900,000 were also paid. The 1934–5 Budget closed with a surplus of nearly £3 millions. Prosperity was already in full swing, at least in the urban areas of South Africa. But it is important to note that so rapidly did the Union's imports increase with expanding internal purchasing power that her export surplus fell from £45 millions in 1933 to £15 millions in 1934.

The Ottawa Agreements.

In judging the effects of the Ottawa Economic Agreements, the evidence of statistical facts, though unquestionable in itself, cannot be final proof; for many powerful forces, of which the Ottawa Agreements may or may not have been among the most important, were playing upon the trade of the British Empire and making the evidence hard to interpret. Those forces included the further fall of sterling against gold, the abandonment of the gold standard by South Africa, and the additional depreciation of the New Zealand pound. Such influences as Great Britain's internal revival or the rise in the prices of certain primary products may themselves have been affected, in their turn, by the existence of the Ottawa Agreements, but they certainly obscured the proofs of how those

Trade of the United Kingdom

1. Imports (*as percentages*)

From	*1929*	*1932*	*1933*	*1934*	*1935*	*1936*
Irish Free State .	3·7	3·8	2·6	2·4	2·5	2·4
Canada . .	3·8	6·1	6·8	6·9	7·4	8·8
Australia . .	4·16	6·6	7·2	6·8	7·2	7·2
New Zealand .	3·9	5·3	5·5	5·5	5·0	5·1
Union of S. Africa .	2·1	2·2	2·1	1·6	1·8	1·6
Total, Dominions	18·0	24·0	24·3	23·2	23·9	25·1
India . . .	5·2	4·6	5·5	5·8	5·4	6·1
Colonies* . .	5·6	6·8	7·1	8·1	8·3	7·9
Total, Empire .	28·8	35·4	36·9	37·1	37·6	39·1
Foreign countries .	71·2	64·6	63·1	62·9	62·4	60·9
	100·0	100·0	100·0	100·0	100·0	100·0

* Together with Newfoundland.

2. EXPORTS (*as percentages*)

To	*1929*	*1932*	*1933*	*1934*	*1935*	*1936*
Irish Free State .	5·0	7·1	5·2	4·9	4·8	4·8
Canada . .	4·8	4·5	4·7	5·0	5·0	5·2
Australia . .	7·4	5·5	5·8	6·6	6·9	7·3
New Zealand .	2·9	2·8	2·6	2·9	3·1	3·9
Union of S. Africa .	4·5	5·0	6·3	7·6	7·9	8·5
Total, Dominions	24·6	24·8	24·7	27·1	27·7	29·7
India . . .	10·7	9·3	9·1	9·3	8·9	7·8
Colonies* . .	8·6	11·2	10·7	10·5	11·4	11·4
Total, Empire .	43·9	45·3	44·5	46·9	48·0	48·9
Foreign countries .	56·1	54·7	55·5	53·1	52·0	51·1
	100·0	100·0	100·0	100·0	100·0	100·0

* Together with Newfoundland.

3. RE-EXPORTS (*as percentages*)

To	*1929*	*1932*	*1933*	*1934*	*1935*	*1936*
Irish Free State .	9·3	11·9	9·4	10·3	8·9	8·1
Rest of Empire .	2·8	10·7	11·9	11·3	10·9	9·8
Total, Empire .	12·1	22·6	21·3	21·6	19·8	17·9
Foreign countries .	87·9	77·4	78·7	78·4	80·2	82·1
	100·0	100·0	100·0	100·0	100·0	100·0

4. VALUES (*in millions of £'s*)

	1929	*1932*	*1933*	*1934*	*1935*	*1936*
Imports:						
British Empire .	359	248	249	272	285	333
Foreign countries	862	451	426	460	471	849
Total . .	1,221	699	675	732	756	516
Exports:						
British Empire .	324	166	163	186	204	217
Foreign countries	405	199	204	210	222	224
Total . .	729	365	367	396	426	441
Re-exports:						
British Empire .	15	9	10	11	11	11
Foreign countries	110	42	39	40	44	49
Total . .	125	51	49	51	55	60

agreements were working. Let us therefore simply record, without attempting to draw too exact conclusions from it, the course of Great Britain's trade with the Dominions and colonies and with foreign countries from 1932 onwards (adding a pre-depression year for purposes of comparison).

The Import Duties Act went into operation in March 1932, and the Ottawa preferences in November of the same year. Hence, quite apart from any other influences at work, it is impossible to tell from such general statistics to what extent any increase in the proportion of trade done by the United Kingdom with the overseas Empire was due to the enlargement of Imperial preferences and to what extent to the curtailment of manufactured imports, most of which came from foreign countries. The Irish Free State has been grouped with the Dominions, but she signed no trade agreement with the United Kingdom at Ottawa, and the trade between the two countries from 1932 onwards was governed by the so-called tariff war arising out of the dispute over the land annuities. If the Free State is omitted, the proportions of British trade with the rest of the Empire were as follows: imports, (1929) 25·1 per cent., (1932) 31·6 per cent., (1933) 34·3 per cent., (1934) 34·7 per cent., (1935) 35·1 per cent., (1936) 36·7 per cent.; exports, (1929) 38·9 per cent., (1932) 38·2 per cent., (1933) 39·3 per cent., (1934) 42·0 per cent., (1935) 43·2 per cent., (1936) 44·1 per cent. The importance of South Africa in the rise in the export percentage is obvious from the table.

As far as this evidence goes, the Ottawa Agreements apparently secured a certain diversion of British trade from foreign countries to the rest of the Empire, both on the import and on the export side. But how far this diversion was due simply to higher tariffs against foreign goods, both in the United Kingdom and in the Dominions, and how far to a 'clearing out of the channels of trade between ourselves' (in Mr. Baldwin's words at the opening of the Ottawa Conference), is far more difficult to determine. The Ottawa Agreements could not, in the nature of things, cause any material freeing of the United Kingdom's import trade; for the principal products of the Dominions had not been subject to duty before the Conference. There was undoubtedly a

perceptible reduction in Dominion tariffs on United Kingdom goods after 1932; but other influences reinforced the Ottawa undertakings in bringing it about—shifts in political power, for instance, or the release of the economies of the Dominions from the worst stringencies of the crisis.

Many people had regarded the general clauses of the Ottawa Agreements between the United Kingdom and Australia, Canada, and New Zealand as the most important feature of the agreements and as the one most likely to secure a liberation of trade by reducing Dominion tariffs. In these general clauses each of the three Dominions promised to give tariff protection only to those industries which were reasonably assured of sound opportunities of success, and not to raise tariff duties above a level which would give United Kingdom producers full opportunity of reasonable competition on the basis of the relative costs of economical and efficient production (provided that special consideration might be given to industries not yet fully established). The Australian Tariff Board, in its report for 1932–3, remarked that the interpretation placed upon the clauses by affected parties had been as divergent as their interests. The Board themselves held, in general, that the Ottawa clauses merely gave statutory authority to their own established policy. They described the undertaking not to provide tariff protection to industries which were not reasonably assured of sound opportunities of success as 'a very sound and important qualification to apply before the imposition of any duty'.

'It is important to remember, however [ran the Report], that the Board's recommendations are to a certain extent circumscribed by the actions of the past. It is one matter to decide the limit of protection which should be granted to an industry not yet established, but quite another to decide what to recommend in respect of an industry which has commenced operations under cover of a very high protection and has become involved in heavy capital expenditure. . . . To interpret Article IX as demanding the abolition of duties in all such cases would inevitably result in hardship and unemployment.'

The Board in such cases had made a practice of recommending a rate of duty which, while limiting the excess cost of local

production, would enable the industry to retain a proportion of the market and to have an opportunity of qualifying for greater output.

With regard to the second general clause of the Ottawa Agreement the Board took a similar broad and compromising view. Some people had assumed, they declared, that the giving of 'full opportunities of reasonable competition' entailed finely adjusting duties so as to place efficient manufacturers of the United Kingdom and of Australia on exactly the same price-level in the Australian market. Such a practice would seriously dislocate industries which had been established in Australia for years, and would lead to an increase of unemployment and to much capital wastage. The subversive consequences of such a policy, they remarked, could not fail to engender opposition to the Ottawa Agreement.

> 'The Board, therefore, while heartily supporting the competitive principle in tariff-making, rejects the idea that the duties should be merely equalizing. . . . The problem of reasonably interpreting the agreement involves much more than an arithmetical calculation of the difference between the costs in the United Kingdom and in Australia. Each case must be considered on its merits and judgement given after a close examination of all available relevant facts.'

In its Report for 1933–4 the Board made known further details concerning its method of examining and judging upon the 'available relevant facts'. Its practice was to try to ascertain a reasonable selling price for locally manufactured goods, paying attention to the level of profits and to the industrial efficiency of the industry, including distributive costs. Sometimes, when costs of production could not be exactly ascertained, the test was used that 'prices in Australia should not exceed a certain proportion in excess of known reasonable prices in the United Kingdom'. This proportion would vary from industry to industry. Investigations under the Ottawa Agreement had shown that in a number of industries labour costs in Australia, expressed in Australian currency, were approximately half as much again as those in the United Kingdom, expressed in sterling. In some industries the ratio was higher and in some lower.

The reduction of Australian import duties in favour of United Kingdom producers was furthered by the attitude of the Tariff Board towards the question of exchange on London. (The Australian pound was depreciated by 20 per cent. against sterling.) The Board held that the premium on sterling had 'increased the protection afforded local industry well above the rates which must have been considered reasonable when adopted by Parliament'. In their 1933–4 Report they announced that they would present their findings under three headings: first, the rates which would prove reasonable under existing exchange conditions; second, an estimate of the rates which would be reasonable if the exchange suddenly reverted to par; and third, the scale of adjustment necessary to meet conditions of exchange between parity and the existing exchange rate.

It is remarkable that a precisely opposite view on this question was adopted by the New Zealand Customs Tariff Commission, which had been appointed to advise on the carrying out of the Ottawa Agreement.

> 'If [they declared] the currency is stable within close limits over a considerable period, economic values will adjust themselves to it; but if the currency is constantly fluctuating in value, an attempt to compensate this by tariff adjustments would be likely to make the position worse.
>
> 'We are opposed to making variations in tariff rates for the purpose of off-setting the protective effect of a depreciating or depreciated currency. . . . It seems to us unsound in principle and based on a misunderstanding of the effect of exchange and currency depreciation upon prices. It is generally considered that currency depreciation exercises a protective effect only during the actual process of depreciation. . . .
>
> 'The major effects of depreciation, we think, are soon worked out.'

Perhaps the only comment that is in place here on this difference of opinion between two well-advised and competent bodies, set up in economically similar countries to consider the same problem, is that they could not both be correct in their final judgement, though the arguments to which each had paid special attention might themselves be sound.

On the question of interpreting the Ottawa Agreement, however, the general views of the New Zealand Commission were not altogether unlike those of the Australian Tariff Board. The article of the Agreement denying protection to industries not assured of sound opportunities of success 'crystalized and embodied', they said, the policy already pursued in New Zealand. The other general undertaking was intended, in their view, to give the United Kingdom manufacturer a 'fair deal' in the New Zealand market, 'in the sense in which that popular though vague expression would be understood by a reasonable and fairminded man'. A high degree of mathematical accuracy, they continued, could not be expected or attained in the actual calculations of tariff rates based on comparisons of relative costs of economical and efficient production.

The tribunals entrusted in Australia and New Zealand with advising their Governments on the carrying out of the general Ottawa undertakings may be described as technical authorities. The Australian Tariff Board was a permanent body already experienced in the adjustment of tariffs, while the New Zealand Tariff Commission, though formed *ad hoc*, was under the chairmanship of the permanent head of the Customs Department. In Canada, on the other hand, the like task was entrusted to a semi-judicial body, presided over by a High Court Judge and inexperienced in matters of customs administration. This difference in the character of the tribunals was expressed both in procedure and in results. In Australia and New Zealand a wide series of duties (in the latter Dominion the whole protective tariff) was reviewed in one survey, and a number of important adjustments made on the strength of the available evidence on costs and prices. In Canada the Tariff Board examined individually, in the manner in which a complicated commercial case might be tried in the High Court, a series of separate appeals for revision of individual duties. Among these appeals the most important, in the first two years after the Ottawa Conference, was that of the British manufacturers of woollen textiles for a reduction of duties on their products. Preliminary inquiry into the woollen textile case was begun by the Tariff Board in June

1933, but it was not until the end of May 1934, almost a year later, that the Board's interim report was tabled in the Canadian House of Commons. The greater part of the report was given over to reviewing the nature and reliability of the evidence that had been submitted. The Board, having remarked upon the lack of conclusive evidence about British and Canadian costing methods, declared that a complete check of costs would require a thorough study of the records and costing methods of each firm that had been represented in the inquiry. Their general conclusion was that, in the absence of greater certainty about the various factors, they did not feel justified in making any definite findings about the scale of duties at that time, but would continue their investigations. Since the woollen textile inquiry had been widely regarded as a test case in the application of the Ottawa clauses, the Board's conclusions were naturally very disappointing to British exporting interests. Though some of the later cases resulted in certain minor reductions of tariffs, the disappointment persisted.

While the woollen textile inquiry was proceeding, an important issue concerning the rights and powers of the Tariff Board was fought out. In October 1933, and on several subsequent occasions, importers of British goods into Canada appealed to the Board against the arbitrary valuation of such goods for duty purposes. These arbitrary valuations, formerly authorized by Order in Council, had been used in effect to raise the amount of duty payable; when the Customs Act was revised in accordance with the Ottawa Agreement, British goods, it was understood, had been exempt from arbitrary valuation. The Tariff Board, in the cases brought before it, ruled to this effect, and directed that excess duty paid according to arbitrary valuations should be refunded. On the 26th March 1934, however, an Order in Council was promulgated referring three questions concerning the jurisdiction of the Tariff Board to the Supreme Court. The latter, in a judgement delivered on the 15th June, declared that the Tariff Board had no authority to determine questions of law as distinct from questions of fact, or to annul valuations for duty purposes made by the Minister of National Revenue before

the Customs Act was amended in November 1932, and that decisions of the Board about valuations for duty purposes were subject to the approval of the Minister of National Revenue. This decision was regarded as another serious impairment of the efficiency of the Canadian procedure in carrying out the Ottawa Agreement in the direction of reducing duties on United Kingdom goods.

The attitude of the Dominions towards the lowering of their preferential tariffs in favour of United Kingdom goods was being seriously affected, during the period now under review, by the development of the British Government's agricultural policy. In this connexion the New Zealand Commission on the Tariff had prefaced their report with an important warning. The Dominion's past tariff policy towards the United Kingdom, they said, appeared to have been based on the tacit assumption that the British market for her exports was indefinitely open at satisfactory prices.

> 'If this should cease permanently to be the case as a result of the application of a quota system or other restrictive device to our staple exports, doubtless attention would be directed to some modification of our policy, such as a search for alternative export markets, or the expansion of our home market and a consequent redistribution of the balance of our productive resources.'

The Ottawa Agreements were the first occasion upon which the United Kingdom Government put into practice their view that the salvation of agriculture lay in the raising of prices from artificially low levels by means of the regulation of production, and that an important step towards such regulation was the quantitative control of imports into the United Kingdom. The agreements laid down that imports of foreign frozen beef and frozen mutton and lamb should be progressively cut to 65 per cent. of their 1931-2 amounts. The Australian Government undertook to limit the export of frozen mutton and lamb to the United Kingdom in 1933 to the level of the 1931-2 shipments, and to use its best endeavours to ensure that exports of frozen beef in 1933 should not exceed 110 per cent. of exports in the base year. New Zealand undertook merely to give reliable estimates of shipments of mutton and lamb as early as possible in each export season. The

United Kingdom Government, in return, undertook that no restriction would be applied to imports of meat from New Zealand and Australia up to the 30th June 1934. As for chilled beef, which had not hitherto been exported in appreciable quantities by the Dominions owing to their greater distance from the market, foreign supplies were to be kept down to the 1931–2 amounts. The Ottawa Agreement on meat was reinforced by a plan of voluntary regulation of supplies, which was agreed upon between the United Kingdom and Argentina, as well as the Dominions concerned, in November 1932. Argentine beef exports to the United Kingdom were to be cut down by 10 per cent., and mutton and lamb by 20 per cent. The Dominions would cut down their mutton and lamb exports by 10 per cent. Part of the bargain with Argentina was that no import duties should be levied on meat before November 1936. The United Kingdom Government had undertaken at Ottawa not to impose duties on Dominion meat during the currency of the agreements, that is to say until November 1937.

The obligation not to impose quantitative restrictions on meat from Australia and New Zealand expired at the end of June 1934, but in view of their strongly expressed objections to the restriction of output only temporary arrangements were made after that date, up to the time of the Dominion Prime Ministers' visit to London in the following year upon the occasion of the King's Silver Jubilee. The United Kingdom Government had meanwhile given temporary assistance to the home cattle industry in the form of subsidies on cattle sold for slaughter. They proposed to the Governments of Australia and New Zealand and of Argentina that in lieu of quantitative restrictions a levy should be charged on imports of meat, with a preference in favour of the Dominions, from the proceeds of which would be paid the subsidy to home farmers. The Governments of both the Dominions concerned, and of Argentina, objected to this proposal, which would, of course, have run counter to the British undertakings not to impose import duties on their meat before November 1937 and November 1936 respectively. The outcome of discussions between the United Kingdom and Dominion Governments in 1935 and 1936 was that the latter's argument carried the day, Dominion

meat being made subject neither to compulsory restriction nor to import duties in the United Kingdom market. Australia and New Zealand agreed, however, to maintain voluntarily certain limitations on their meat exports. A duty equivalent to about 20 per cent. *ad valorem* was imposed on foreign meat.

The low prices ruling for dairy products precipitated a similar problem in this industry also. Not long after the Ottawa Conference the New Zealand Government asked the Government at Westminster whether it would not be possible to restrict imports of foreign dairy products into the United Kingdom, with a view to raising the price obtained by Dominion producers. The Westminster Government replied that they could not sufficiently cut foreign imports without applying some restriction to Dominion butter and cheese also; they therefore suggested that the Dominions should agree to curtail their exports by 10 per cent., foreign imports to be thereupon cut by 20 per cent. Neither New Zealand nor Australia was able to assent to this proposal, which was denounced in some quarters in those Dominions as a breach of the spirit of Ottawa. Since the Ottawa Agreements precluded the British Government from restricting the import of Dominion butter and cheese until November 1935, they found themselves obliged, as in the meat industry, to provide a money subsidy for home producers, in the form of minimum prices for milk for manufacture.

The determination of the United Kingdom Government to afford protection—whether by tariffs, quotas, subsidies, or other means—to all the main branches of British agriculture was obviously undermining one of the essential bases of the Ottawa Agreements. The principles upon which they were tacitly founded included the continued free entry of primary products from other parts of the Empire into the United Kingdom market. If that principle were to be permanently abolished, not only would a new foundation have to be found for Imperial agreements on trade and tariffs, but other economic problems of the British Commonwealth would be vitally affected, including the investment of capital and the flow of migration.

(c) *The United States*

The revaluation of the dollar at 59·06 per cent. of its former gold content, on the 31st January 1934, marked the end of one phase of American economic policy and the beginning of another. Though the United States continued to be an importer of gold, the abnormal flow that immediately followed the revaluation came to an end before March was out. For many months thereafter, the external currency relations of the United States did not enter prominently into public controversy.

Indirect consequences, of course, there were, both at home and abroad. While the under-valuation of the dollar meant for foreign countries trade difficulties and losses of gold, for the United States it meant both a release of internal economic policy from almost all monetary restraints, and a growing surplus of exports over imports. In 1934 her outward balance of commodity trade amounted to \$478 millions. Net imports of gold between April and December amounted to \$445 millions. Imports of gold in February and March, totalling \$690 millions, had exceeded the net losses of the previous two years by about \$70 millions. Hence, broadly speaking, the United States took payment for her 1934 excess of exports entirely in gold.

It might have been supposed that with rising exports, and with a credit policy backed by mounting gold reserves, the United States would have enjoyed a progressive industrial advance. But this was not so. Between October 1933, when the gold-buying policy was initiated, and October 1934, the index[1] of production in manufacturing industries fell from 76 per cent. to 73 per cent. of the 1923–5 average. Factory employment and pay-rolls showed a slight improvement, but not enough to compensate for the increase of population and the rise in prices; for retail food prices were over 8 per cent. higher in October 1934 than they had been in October 1933. The conclusion can scarcely be escaped that the workers attached to factory industry were, if anything, worse off at the end of 1934 than they had been when the new currency policy

[1] Indices adjusted for seasonal variation.

was initiated; unemployment was as bad among them as it had been a year earlier, and their wages could buy less.

Why were expectations thus falsified? Two main reasons stand out among many; the first was the hindering of industrial recovery by labour disputes, and the second, which arose in some measure out of the first, was the insufficiency of business confidence. Cheap money and inflated purchasing power failed to persuade the directors of enterprise that capital expansion was timely. Industries producing capital goods lagged far behind those producing goods for consumption, and the iron and steel trade in particular fell back, in the summer of 1934, into almost as deep a depression as it had experienced in the worst days of the slump.

Industrial disturbance was, perhaps, inevitable when a measure of the scope and character of the National Industrial Recovery Act was applied to a country like the United States. It was not that the provisions of the Act were socialistically very far advanced by standards of practice in, say, Great Britain or Germany; but they were superimposed upon an individualist tradition and a code of competitive capitalism which had bitten deep into national thought and conduct. In particular, trade unionism and the principle of collective bargaining had been regarded by the mass of Americans outside the unions themselves with distrust and animosity. The American Federation of Labor had represented mainly the comparatively well-paid, skilled artisans. One of the reasons for the weakness of trade-union organization in poorly paid unskilled occupations was the fact that labour of this class had been largely recruited from among the immigrant population. Not only were these immigrant workers often prepared to accept lower wages than native-born Americans; their continual influx at the lower levels of the economic and social scale prevented the emergence of a stable industrial proletariat informed with class consciousness. The slowing down of immigration after the War was already altering the foundations of the American social system. The slump, by destroying hopes of rapid progress up that economic and social scale, and by afflicting even the highly paid and successful worker with the chronic fear of unemployment, changed the scene beyond

recognition. The electoral triumph of President Roosevelt, with his brief for the 'forgotten man', was followed by the passage of the National Industrial Recovery Act, with its clauses giving Government endorsement to trade unionism and Government sanction to the fruits of collective bargaining. The trade unions, with their new sense of working-class solidarity and their new socialistic aspirations, were in an aggressive and ambitious mood.

All three major labour disturbances in the United States in 1934—the motor-industry dispute in March, the San Francisco general strike in June, and the textile strike in September—as well as the intermittent and often serious troubles in the steel industry, may be traced more or less directly to the question of trade unionism and of the workers' representation for the purpose of collective bargaining. Section 7 (*a*) of the National Industrial Recovery Act laid down that employees should have the right to organize and bargain collectively through representatives of their own choosing, and that no employee should be required, as a condition of employment, to join any company union or to refrain from joining a labour organization of his own choosing. This section was designed to prevent employers from compelling all their employees to belong to a company union (i.e. a union limited to the particular concern, and suspect by Labour—not always unjustifiably—as subservient to the employer's interests), or from forbidding them to belong to other unions. But it left exposed a wide area of possible dispute over the question who should represent the men in collective bargaining and in the elaboration of N.R.A. codes—the company unions, the craft unions represented in the American Federation of Labor, or national industrial unions, of which the Amalgamated Clothing Workers' Union and the United Mine Workers were at that time the chief examples, and which later became the main constituents of the Committee for Industrial Organization.

In the motor industry a grave strike threat was averted in March 1934 as a result of conferences between the President and representatives of employers and workers. The parties accepted a scheme of joint 'works councils', and the employers agreed not to discriminate against any employee on account

of his union membership. At the end of June a grave strike, which threatened in the steel industry, was averted (this time through the mediation of Miss Perkins, the Secretary of Labor) by the appointment of a board of three impartial arbitrators who in future were to settle differences between employers and workpeople.

The similar board appointed by the President to mediate in the longshoremen's strike on the Pacific coast did not meet with equal success. The rights and wrongs, and even the precise issue, of the original dispute were obscure, but it soon developed into a battle over the character of employees' representation. Other unions in San Francisco and other Pacific cities took up the longshoremen's case, and on the 14th July 1934, after a series of sympathetic strikes, delegates of 115 unions decided by a majority (not counting abstentions) to call a local general strike as from 8 a.m. on the 16th July. The President was then on holiday, cruising in the Pacific. The strike began at the appointed time. Thousands of people, fearing a shortage of food, had already left San Francisco and Oakland. Four thousand National Guardsmen, equipped with tanks and a field artillery unit, were stationed on the water-front, while 1,800 regular and special policemen were mustered to prevent any outbreak of violence. The Strike Strategy Committee had its own patrols in the streets to prevent excesses by strikers. It permitted the delivery of milk and bread and of supplies to hospitals and other public institutions. Petrol proved one of the scarcest and most necessary commodities that were held up. On the 17th July the Committee passed by a narrow majority a resolution appealing to the President to intervene, on the basis of the submission of all questions involved in the water-front dispute to arbitration by the President's Longshore Board. On the 19th they voted to end all sympathetic strikes, after the President's Board had promised that the maritime unions, which had accompanied the longshoremen on strike, would get full consideration in the arbitration. The strike, though most intense in San Francisco, had extended over most of the Pacific coast north of Los Angeles. It had provoked some bloodshed and much public bitterness, but it had been on the whole orderly, and not

unsuccessful in forcing to an issue a dispute that for many weeks had poisoned industrial relations and injured trade and industry in the Far West.

On the 1st September 1934 a great strike began in the textile industry, 400,000 to 450,000 employees obeying the call to cease work. The first of the several issues involved was the familiar one of trade-union recognition—the demand that the employers and the code authorities should accept the United Textile Workers as the sole collective bargaining agency of the industry. Before the régime of N.R.A., this union had had a membership of some 20,000; but by May 1934 it claimed a membership of about 300,000 in the cotton textile industry alone. Other demands of the strikers included the creation of effective machinery for enforcing the labour provisions of the N.R.A. code, the same pay for a 30-hour week as had been fixed under the code for a 40-hour week when the industry was running fuller time,[1] and the regulation of the 'stretch-out' in the interest of the workers.

The strike was bitter and bloody, especially in the South, where wages were a good deal lower than in the New England mills. In the course of it, 16 people were killed and 200 wounded. For various reasons, chiefly the incompleteness of trade-union organization and membership, the strike was never more than partial, and the men were further handicapped by shortage of money. Federal relief funds, on which they had counted, were in most cases refused to strikers. After three weeks the strike was called off. On the main issue of trade-union recognition the workpeople were unable to secure the support of the Federal board of inquiry, which declared that 'an industry-wide collective agreement between the employers as a group and the United Textile Workers' was not at that time 'feasible'.

Thus, the principal labour disputes in 1934 had been settled without exception through Government mediation, usually by way of the nomination of an arbitral board to settle either the immediate issue or future labour differences in the industry concerned. Yet conciliation and arbitration clearly could not

[1] The index of production in the textile industry fell by no less than 42 per cent. between June 1933 and June 1934.

solve the main problem of trade unionism and of Section 7 (*a*) of the Recovery Act. On the 8th October the American Federation of Labor formally approved a report of its Executive Council which referred to the 'disillusionment' of Labour with the working of Section 7 (*a*), in so far as many employers were refusing to allow collective bargaining by their employees. It instructed the Executive Council to obtain legal outlawry of company unions. On the same occasion the Federation unanimously resolved to make the 30-hour week in all industry a paramount objective of its policy. The unfortunate Section 7 (*a*) was also subjected to severe legal buffeting. On the 24th February 1935 the Federal Court at Wilmington, in the case of the Federal Government against the Weirton Steel Company, declared that the section, as applied in this instance, was unconstitutional and void, since it purported to assert the authority of Congress in a field of commerce other than that allotted to it by the Constitution, namely, inter-state and foreign commerce only. This judgement was to be reinforced and extended by the Supreme Court in the Schechter case.

Meanwhile, on the 18th June 1934, the seventy-third Congress of the United States had adjourned *sine die*. This was the Congress elected at the same time as President Roosevelt himself, and called by him into special session in the fateful days of March 1933. Its departure from Washington marked the end of the second phase of the New Deal; the first was the emergency phase, the second the phase of legislative consolidation. Several of the legislative enactments of 1934, of course, rounded off or reinforced the policies adopted in the emergency period; such, for instance, was the Bankhead Cotton Control Act, imposing a penal tax upon farmers whose cotton production should exceed an allotted quota; or the Gold Reserve Act, the foregone conclusion of the suspension of the gold standard and the purchase of gold at home and abroad at progressively mounting prices. Other Acts projected the policies of the New Deal into new fields. There was the Housing Act, authorizing the Federal Government to extend loans for building and to guarantee mortgages on houses to a total of more than $3,000 millions. There were

the measures subjecting stock and commodity exchanges to official control. There was the Silver Purchase Act, which declared it to be the policy of the United States to keep 25 per cent. of its monetary reserves in silver.

The stimulation of housing with the aid of Government credit was designed not only as a measure of unemployment relief but also as a remedy for a very serious situation in the residential building industry. In 1932 the total of contracts awarded for residential building was little more than one-third of the total in 1931, and in the following year it was lower still. The first six months of 1934 showed practically no improvement, and half-way through the year employment in the brick and tile industry was no more than 30 per cent. of the 1923–5 average. This contrast with conditions in Great Britain, where the corresponding figure was 130 per cent., sheds a good deal of light on the difference between the economic state of the two countries at this period of their tentative recovery from the slump. Building in Great Britain was stimulated by cheap money and by low prices of materials, which more than compensated, as far as total output was concerned, for the withdrawal of part of the Government assistance to the building of working-class houses. In the United States, building was held back by lack of confidence and by inflation of prices under N.R.A. codes. The want of confidence among potential mortgagees was enhanced by the passage of the Frazier-Lemke Farm Mortgage Act, which virtually prevented foreclosure on farm properties for a period of five years. The Act was, however, declared unconstitutional by the Supreme Court on the 27th May 1935.

On that date the Supreme Court delivered its judgement on the Schechter case, denying the constitutionality of the major provisions of N.R.A. In his message to Congress on the 3rd January 1934 Mr. Roosevelt had declared that in N.R.A. they had created 'a permanent feature of our modernized industrial structure'. He praised the Act for the restoration of millions of unemployed to work, for the abolition of child labour, and for the self-organization of industry on the strength of a greater understanding that reasonable profits were compatible with adequate wages and proper conditions of work.

'We seek [he said] the definite end of preventing combinations in furtherance of monopoly and in restraint of trade, while at the same time we seek to prevent ruinous rivalries within industrial groups.'

Three months later, his emphasis had shifted.

'The whole objective of the N.R.A. is to raise public purchasing power [said the President]. With millions still unemployed, the purchasing power of the people is still greatly curtailed. It can only be increased and sustained by striving for the lowest schedule of prices on which higher wages and increasing employment can be maintained.'

And by the 30th September his enthusiasm for the permanence of N.R.A. had been whittled down to a declaration that 'those functions of the Act which have proved of worth will be made part of the permanent machinery of government'.

The fact was that in 1934 the remorseless harrow of events had exposed to the day the buried inconsistencies of the N.R.A. scheme. Three main motives had animated its construction—the belief of certain business leaders in 'industrial self-government', the need for legislation to protect the workers against the effects of chaotic competition, and the theory that unemployment could be diminished by spreading more extensively the available volume of work. This last theory was generally combined or confused with the theory that high wages meant increased purchasing power, which in turn meant higher profits. Such a criss-cross of motives was bound to lead to conflicts in practice. One by-product was the reduced purchasing power of individual earnings, through the greater rise in the cost of living than in average factory wages. The high-wage theory was trapped in reverse gear. Still more paradoxical was the spectacle of the N.R.A. authorities obtaining injunctions to stop trading at prices lower than those specified in the codes, while another department of Government was simultaneously seeking process against meat-packing companies and others, whom it accused of conspiring to manipulate and control prices.

The history of N.R.A. in 1934 was largely the story of the reconsideration, and eventually of the practical abandonment, of the price-fixing provisions of the codes. Early in

that year the Consumers' Advisory Board established under the Act presented a scathing report declaring that the effort to increase purchasing power through N.R.A. had too often been nullified by excessive increases in prices, assured or facilitated by monopolistic practices authorized or encouraged by the codes. Some weeks later there was published the report of the National Review Board, under the chairmanship of Mr. Clarence Darrow, appointed by the President to ascertain whether any N.R.A. codes were 'designed to promote monopolies or to dominate or oppress small enterprises'. This nominally interim report was savagely hostile to the existing practice under N.R.A. One section of the Board's members demanded revival of the anti-trust laws (from which codified industry had been released), while the other demanded a 'planned economy', with socialized ownership and control of industry.

On the 7th June the National Recovery Administration announced that it would no longer fix prices in its codes of fair practice for industry, except in well-defined emergencies. The price-fixing provisions of the existing N.R.A. codes were allowed to fall into neglect, and when, in December 1934, official plans for a revised N.R.A. were published, the price-fixing element had practically disappeared. At the end of September General Johnson had resigned from the position of Administrator, and the post was replaced by two boards, one for general policy and one for administration. Mr. Donald Richberg succeeded the General as 'chief of staff' in the N.R.A. Midway through 1935 the National Industrial Recovery Act, adopted as an emergency measure with two years' life, was due to expire, and the prospect of rewriting it as part of the permanent framework of American legislation was giving rise to much propaganda and debate. The Darrow Committee had indicated the inevitable choice of economic designs—*laisser-faire* in the interest of the public as consumers, or Socialism in the interest of the public as workers. The straddling policy of regulated monopoly under N.R.A. had failed to appease either side.

The death-blow to N.R.A. was delivered by the Supreme Court in its decision of the 27th May 1935 in the Schechter

case. A firm of poulterers of that name had appealed against a conviction for violation of the Poultry Code. The eighteen counts against them included alleged infringements of the wages and hours provisions of the Code, and alleged unfair trade practices. The Court unanimously allowed the appeal on all counts, declaring that the conferring of code-making authority on the President and the industries concerned was an unconstitutional delegation of legislative power. The Court further declared that the Federal Congress and Executive had no constitutional right to regulate industries only indirectly engaged in or concerned with inter-state commerce. No decision could have been more completely and finally hostile to the operative principle of the National Industrial Recovery Act. However skilfully the Administration might find means of circumventing the constitutional obstacles, one stage of the New Deal was thus brought to a sudden close.

For a time there was confusion among business men at Washington, and in financial markets. Mr. Donald Richberg at once announced that all compulsory provisions of the codes would be suspended immediately. The Government, he added, were faced with the question of maintaining the gains and retaining the values created under the N.R.A.

> 'Pending the determination of this question, it would be most harmful to the general welfare should unfair competitive practices be revived or the fair standards regarding labor be disregarded. I hope that all employers and employees will co-operate to maintain those standards.'

The Administration made efforts to restore or retain, by changing their legal bases, some of the subordinate instruments and activities of the N.R.A., and announced that code standards would still be required of those tendering for Government contracts or offering goods for sale to Government agencies—a powerful weapon when 4 billion dollars had been voted for unemployment relief works. The leaders of some of the major industries, too, expressed a determination to maintain the fair-practice provisions of the codes and to uphold 'Blue Eagle' standards.

Had the N.R.A. at that time been a strong and effective system, its destruction overnight might have meant chaos; in

particular, it might have entailed a disastrous outburst of industrial warfare. But where the N.R.A. had not already achieved its purpose it was gradually becoming not more but less effective. It had rallied the ranks of trade unionism, restored to labour the initiative that had been lost during the calamitous years from 1931 to 1933, arrested the Gadarene career of uncontrolled competition in prices and industrial conditions, and given to industrial organizations a sense of authority and public responsibility that they had never before possessed. On the other hand, among the smaller units of industry and trade its provisions had been largely evaded, and it had never succeeded in enforcing industrial or craft unionism, as against company unionism or the open shop, except where the real power lay in the strength of the union itself rather than in the arm of the law. The end of the N.R.A. made the less disturbance in that it was the structure of ideas on which it had been based in many ways conflicted with the inflationary tendency of the period.

While the demise of the N.R.A. certainly had very little direct consequence upon the general trend of American economic affairs, there were many opponents of the New Deal who claimed that it had actually been the signal for renewed economic recovery, because the N.R.A. had acted as a continual check to business confidence. It is unlikely, however, that business would have been permanently stimulated had not the underlying conditions already been favourable. The index of factory employment rose by 8 per cent. between December 1934 and December 1935;[1] the index of factory pay-rolls, in the same interval, rose by 21 per cent.—a clear indication that the average money rate of wages was rising. The index of industrial production meanwhile rose from 85 per cent. to 104 per cent. of the 1923-5 average, an increase of 22 per cent. There was, moreover, a striking change in the relative trends of different groups of industries. From December 1934 to December 1935 the index of iron and steel production rose from 57 to 90, while the general index for

[1] The course of unemployment in the United States cannot be stated accurately owing to the lack of continuous official figures. An official estimate gave 10,915,000 as the figure for September 1935—a quarter of a million less than in October 1933 and 4 millions less than during the crisis of March 1933.

manufactures rose only from 76 to 95. The choice of these months, it is true, accidentally exaggerates the trend, but as between the whole of 1934 and the whole of 1935 the activity of the iron and steel industry increased by 31 per cent., whereas the average increase was only half that percentage. The index of construction contracts awarded—one of the prime movers of recovery—began to rise steadily after May 1935, and at the end of the year stood at more than double the height of the previous December. It may be noted, as evidence of the mutual independence of external and internal trends, that, although American exports increased in 1935, imports increased far more rapidly, and the outward balance of commodity trade was less than half its 1934 amount.

It was not only the Schechter judgement that brought the constitutional issue to the front of American politics and economics in 1935. When the year began, financial markets in the United States were in a state of extreme nervousness in anticipation of the Supreme Court's decision in a series of cases concerning the 'gold clause' in public or private contracts. On the 5th June 1933 the President had approved a Joint Resolution of Congress declaring every provision in any obligation (including those of the United States, except currency) purporting to give a right to demand payment in gold or in a particular kind of coin or currency, or in an amount of money measured thereby, to be against public policy. By a majority of five to four the Supreme Court gave judgement, on the 18th February 1935, in favour of the constitutionality of this resolution as far as private contracts having gold clauses were concerned, but against the right of the United States Government to repudiate their own obligation to pay in gold or its equivalent. The majority ruled, however, that the holders of Government bonds could sue for payment only if they could show actual damage through payment in depreciated dollars; and that the damage sustained could not be measured by the extent of the devaluation of the dollar, since gold was no longer available, but only by reference to changes in the internal economy of the country since the date of the breach of contract. Payment in gold would not recoup the plaintiff's loss, but would enrich him unjustifiably.

Several decisions in cases relating to the processing taxes, which were an integral feature of the Agricultural Adjustment Act, were decided in lower courts against the Government in the course of 1935; but it was not until the 6th January 1936 that the Supreme Court delivered judgement on the A.A.A. Both the Act itself, and the amending Act that had been passed in an attempt to rectify provisions in the original Act that might have been held unconstitutional, were condemned by the Court in sweeping terms. The Act was declared to be an invasion of states' rights and beyond the Federal power under the general welfare clause of the Constitution, which had been pleaded by the Government; the clause could be invoked only in support of Acts for the national and not the local welfare. If the subsidies to farmers were held valid, declared the majority opinion, it would be possible for Congress 'to regulate industry in its most meticulous forms'. This blow to the New Deal was far more serious in practice than the destruction of the N.R.A.; for the A.A.A. was in full operation and had become, with other measures of a similar kind like the Bankhead Cotton Act, a crucial part of the economy of American agriculture. A billion dollars had been paid to farmers during the life of the Act, as an inducement to reduce their acreage under various crops, and had been provided by processing taxes which had now been declared illegal. The best that the Administration could do, within the Constitution, to replace this aid to farmers was to offer subsidies for the growing of grasses and other crops that might help towards conserving the soil; they could no longer recoup themselves from processing taxes, and were forced to lay this extra burden on the general Budget. Partly as a result of the A.A.A., but probably more by reason of the natural conditions that produced smaller crops, the prices of farm products had risen on the average by 20 per cent. between 1934 and 1935, after a 27 per cent. rise in the previous year; with the payments under the A.A.A. and other Acts, the income of the agricultural community was probably higher in 1935 than in any year since 1929.

In a Budget message to Congress, delivered almost at the very hour when the Supreme Court was ruling the processing

taxes illegal, the President had estimated the yield of these taxes in 1936–7 at $547 millions. Early in 1934 Mr. Roosevelt had declared that the Government 'should plan to have a definitely balanced budget for the third year of recovery (i.e. 1935–6), and from that time on seek a continuing reduction of the national debt'. The revised estimates for 1935–6 actually showed revenue at $4,411 millions and expenditure at $7,645 millions, and even before the loss of the processing taxes the deficit in 1936–7 was estimated at over a million dollars.

The destruction of the A.A.A., and the announcement of these figures, fanned the half-extinguished fears that inflation and its fellow, currency devaluation, were in prospect. When, on the 10th January 1936, the President issued a proclamation prolonging for one year his powers under the Gold Reserve Act of 1934 to reduce the gold parity of the dollar to 50 per cent., from its existing position of a little under 60 per cent., the fears flamed into positive expectation. The presidential proclamation declared that the emergency existing in January 1934, when the Gold Reserve Act was signed, had not been terminated by international monetary agreement or otherwise, but, on the contrary, continued and had been intensified in divers respects by unsettled conditions in international commerce and finance and in foreign exchange. A sufficient explanation of Mr. Roosevelt's decision could indeed be found in the fact that to have abandoned the right to devalue the dollar further would have been in effect to restore it to the gold standard, at a time when other important currencies like the pound sterling were still unstabilized, and would therefore have gravely weakened the negotiating strength of the United States in any later discussions of all-round stabilization. To have allowed his powers to expire would have been a more remarkable gesture than to have retained them. This, however, was not the interpretation favoured by nervous holders of dollar funds, and their apprehensions were magnified by the simultaneous passage of the Veterans' Bonus Bill through the House of Representatives by a large majority. The Bill, without specifying where the money was to come from, authorized the payment of the bonus immediately and in cash. The

President vetoed the Bill, but on the 25th January his veto was overridden by the House by a majority of 324 to 61.

The prospect of immediate payments of some 2 billion dollars to veterans was scarcely reassuring to those who feared the inflation of the currency. On the 3rd February the dollar dropped to its lowest point since August 1934, and in Paris it fell to a level at which the export of gold to France became profitable. Some eastward shipments of gold across the Atlantic actually took place. The movement, however, could hardly be considered a buttress for the franc, since any fall of the dollar would still further weaken the bases of the European gold currencies; hence the franc simultaneously fell against the pound. As on previous occasions, the authorities of the Exchange Equalization Account intervened to arrest the decline, with the result that the three currencies were for the time being pegged to each other.

The years 1933 and 1934 had seen the great effort of the New Deal—the devaluation of the dollar, the creation of the N.R.A. and the A.A.A., the vast expenditures on work relief. Then, the reconstruction and revival of the American economy were being carried on in an era of swift and hazardous experiment in political economy. In 1935 and early 1936 only the passage of the Veterans' Bonus Bill—against the wishes of the Administration—marked the continuance of the experimental era in legislation. Under the pressure of constitutional judgements, of financial exigency, or of political foresight, some of the old experiments were being abandoned, and others had lost their purpose as the foundations of economic recovery became firmer. The year was indeed an interlude of adjustment, and in the autumn of 1935 President Roosevelt himself offered a 'breathing space' for American industry.

(d) *Germany and Her Debts*

Earlier chapters have described the banking collapse in Germany in 1931 and the subsequent agreements restricting transfers on her external short-term and long-term debt. Before resuming the story of the debt negotiations, we must look back at some of Germany's internal economic developments. The aftermath of the financial crisis, and the prelude

to political revolution, was an immense volume of unemployment. The numbers unemployed rose to a peak of 6,192,000 in March 1932; they fell seasonally during the summer months, but by the end of 1932 they once more exceeded $5\frac{1}{2}$ million.

The Government made several vigorous attempts to deal with the problem. A bold and comprehensive scheme, effecting virtually a mortgage on future public finances in favour of present relief, was announced by Herr von Papen at the end of August. First of all, a large programme of works, for which £$17\frac{1}{2}$ millions (at par) had already been found, would be continued and extended. Second, the provision of employment would be subsidized by the payment to employers of a premium of £20 per head for each new employee signed on, up to a total of £35 millions, in the form of negotiable certificates valid for the payment of taxes. The third part of the scheme provided that in receipt for certain taxes, which weighed particularly heavily on industry, taxpayers should be given promissory notes bearing 4 per cent. interest. These notes might be discounted with the Reichsbank, or otherwise negotiated, or they might be retained for payment of taxes, to the extent of one-fifth of their face value per annum, between the years 1934 and 1938. The Chancellor indicated that the ready money which it was hoped would thus accrue to the Government would be used exclusively for the renewal and overhaul of the German productive machine. The Government's expectation was, further, that the promissory notes, by providing potential borrowers with suitable collateral security, would liberate idle funds for the use of industry. The fourth part of the scheme invoked a supposed elasticity of demand for labour. The Government, acting through compulsory arbitration and collective wage agreements, would endorse reductions of wages up to a maximum cut of $12\frac{1}{2}$ per cent., on condition that the employers in question increased their staffs by at least 25 per cent. The total sum hypothetically involved in the whole programme, including public works, tax rebates, and premiums, was stated to be Rm.2,700 millions (£135 millions at par); and the number of unemployed which it was officially hoped might thereby be

absorbed was 1,750,000. The failure to make any large impression upon the unemployment figures up to the end of the year is sufficient testimony to the want of success of the plan. For one thing, trade unions effectively resisted attempts to cut wages further;[1] but the main explanation must lie in the generally depressed state of trade and in the psychological attitude of business men, who were unwilling to accept further risks through expansion of activity even at the premium offered by the Government. In December 1932 the Cabinet decided to proceed immediately with an expenditure of £30 millions on public works. £5 millions of this sum would be drawn from the Unemployment Fund, the remaining £25 millions being covered by unused taxation vouchers under the von Papen programme, which would be placed at the disposal of local authorities for the financing of public works. Apart from these governmental efforts, the Reichsbank endeavoured to stimulate industry by pursuing as liberal an internal credit policy as its resources allowed.

Meanwhile, two important steps had been taken to reorganize German economic life under crisis conditions. The first was the reconstruction of the big banks. Up to 1929, when the Deutsche Bank and the Diskontogesellschaft merged, there had been five great deposit banks in Germany, known as the D-banks: the above two, the Dresdner Bank, the Darmstädter- und Nationalbank (or 'Danat'), and the Commerz- und Privatbank (or 'Compri'). It will be recalled that the German financial crisis of July 1931 began with the failure of the 'Danat' bank, and that the Dresdner Bank was soon involved in similar difficulties, both of them having to receive temporary financial aid from the Reich Government through the Reichsbank. In February 1932 a scheme was announced for the merging of these two great banks. It involved a drastic writing-down of capital, the acceptance of ordinary shares by the Reich, and the provision of fresh loan capital by the Reich and by the Gold Discount Bank. A similar but not so severe reorganization was applied to each of the other two great banks. Changes were also to take place in the managing per-

[1] The average fall in German money wages over the two years 1931–2 was in the neighbourhood of 25 per cent.

sonnel of all the banks concerned. It was announced some time later by the Reich Finance Minister that the total obligation of the Reich resulting from the banking reconstruction was Rm.1,115,700,000 (roughly £55 millions). This did not include Rm.400 millions (£20 millions) of foreign credits advanced to the 'Danat' bank, for which the Reich was still liable under its general guarantee given in July 1931.

The other notable piece of economic reorganization accomplished during 1932 in Germany was the scheme for the state support of the great shipping companies. On the 19th March it was announced that the Hamburg-Amerika ('Hapag') and Norddeutscher Lloyd lines, which together controlled over three-quarters of the German mercantile fleet, would receive from the Reich Government a guarantee for credits to a total of Rm.77 millions (£3,850,000 at par). About Rm.24½ millions would be used for the prolongation of maturing liabilities, Rm.46,400,000 for new credits for the liner business, and the remainder for credits for the tramp-steamer business. For their part, the 'Hapag' and Lloyd companies would reduce their share capital in the ratio of 10 to 3, which transaction, together with the cancellation of reserves, would produce a book profit of about Rm.180 millions in each case, to be used for covering losses and depreciation. They also undertook to reinforce the measures of economy that they had already introduced so as to produce an estimated saving of Rm.45 millions (£2¼ millions) per annum. The reorganization scheme was to be associated with the provision by the Reich Government of Rm.23 millions (£1,150,000) for 'breaking-up bonuses', that is to say, subsidies on the scrapping of old vessels. In this and in other ways there continued during 1932 the progressive 'socialization' of German industry and finance, under the pressure of economic circumstances in which public credit was the only refuge from private bankruptcy.

This process was advanced much farther in 1933 and later years after the advent of the National-Socialist régime. Meanwhile, however, fresh difficulties had arisen on the external side of Germany's economy, in spite of the Standstill Agreement and the transfer moratorium. Her trade balance no longer showed the resilience that it had displayed at the first

onset of the slump. In 1933 Germany's credit balance on commodity trade was only Rm.667 millions, against Rm.1,062 millions in 1932. In March 1934 the Foreign Exchange Control Office reduced the quotas of foreign exchange allotted to importers by 10 per cent.—the first cut for nearly two years. Further restrictions on imports were imposed shortly afterwards. Amid a variety of causes for Germany's failing trade balance, two may be particularly noted—the Jewish boycott, desultory and incomplete, that followed the National-Socialist revolution, and the big decline in German exports to Russia, for political reasons and because of the Soviet Union's new commercial engagements with the United States and Great Britain. But perhaps more important than any such particular incidents was the failure of Germany to adjust her internal economy to the necessities of her external trade. Given the economic condition of the world in 1933, there were available to her two alternative means of maintaining her foreign trade balance. One was to cut costs and prices; the other was to depreciate her exchange. The economic policies of the National-Socialist Government were calculated rather to raise than to diminish internal costs; for they included the inflationary financing of rearmament, and of public works, labour camps, and other salves for unemployment, and the schooling of industry into courses that would involve an increased use of man-power. During 1933 wholesale prices in Germany rose by over 5 per cent., whereas in gold-standard countries they fell slightly. As for the depreciation of the reichsmark, it was strenuously opposed by Dr. Schacht and other authorities, who feared the reactions upon a country that had experienced the horrors of a great inflation only a decade earlier. They preferred the indirect and disguised method of financing exports with cheap Konversionskasse scrip, and with blocked and registered reichsmarks.

In the course of 1934, however, Germany's foreign trade position greatly deteriorated. Her exports fell from Rm.4,871 millions in 1933 to Rm.4,166 millions in 1934, while her imports rose from Rm.4,204 millions to Rm.4,452 millions. An export surplus of Rm.665 millions was thus converted into an import surplus of Rm.284 millions. The gold and foreign

exchange reserve of the Reichsbank dwindled in the course of the year from Rm.396 millions to Rm.84 millions.

When the conference between the Reichsbank and the foreign long-term creditors was held in April 1934 to ratify in permanent form the agreement of the previous January,[1] the transfer situation was already serious. Early in March Dr. Schacht had caused consternation in foreign financial centres by hints of impending cuts in interest transfers, and as the date of the conference approached his warnings became more and more definite. In a broadcast talk on the eve of the conference he declared that 'to establish the complete incapacity of Germany to make transfers it was unnecessary to call an international conference, since the facts were clear to everybody'. Between the German protestations of inability to pay, and the efforts of the creditors to obtain as large a measure of payment as possible, the conference dragged on for nearly five weeks. The official *communiqué* published when it terminated on the 29th May stated that the Reichsbank had made the following offer, to apply to coupons falling due in the year ending on the 30th June 1935. Bondholders might exchange their coupons for funding bonds bearing interest at 3 per cent., the service of which (including a 3 per cent. sinking fund) would not be subject to transfer restrictions. Alternatively, they might receive cash for their coupons at 40 per cent. of their face value; but the Reichsbank reserved the right to withdraw this part of the offer on 30 days' notice.[2] Creditors who did not wish to avail themselves of either of these arrangements would retain all rights under their coupons. This offer was accepted by the British, French, and Swedish delegations, with two provisos: that the requirements of their respective Governments as to the service of the Dawes and Young Loans must be satisfied, and that in the event of the scheme's being operated so as to discriminate between country and country they reserved full liberty of action for themselves and their Governments. The Swiss and Dutch delegations (whose interest lay on the side of discrimination) were unable to

[1] See above, p. 117.

[2] Owing to the shortage of exchange the Reichsbank withdrew the offer of 40 per cent. cash in November 1934.

accept the offer, while the American delegation were content to record that they had taken part in the conference only on the restricted basis on which it had been called, namely, the ending of discriminatory agreements. A few days later the German Government did, in fact, give notice of termination of the special transfer agreements with Switzerland and the Netherlands, and negotiations for new agreements with those countries were forthwith begun.

The German authorities had sought to include the Dawes and Young Loans (the service of which, other than amortization on the latter, was still exempt from the transfer restrictions) within the scope of the April conference. This proposal, however, evoked vigorous protests from the British and French Governments. On the 14th June the Reichsbank declared a complete moratorium on Germany's long-term and medium-term debts, including the Dawes and Young Loans. All cash transfers were to cease for six months, but creditors were offered the other alternatives proposed by the Reichsbank at the April conference. The German Government would pay the service of the Dawes and Young Loans in Reichsmarks into the Konversionskasse, but the transfer of these sums into foreign currencies would be a subject for negotiation with the Governments of the creditor countries, who would be required in return to take additional German imports. The Bank for International Settlements, which was trustee of the Young Loan and fiscal agent for the trustees of the Dawes Loan, immediately protested to the German Government, affirming its intention to defend the rights of the bondholders to the full extent of its power. Equally promptly, the Chancellor of the Exchequer announced in the House of Commons that, unless a settlement fair to British bondholders and to British commerce could be negotiated before the 1st July, legislation would be proposed for the establishment of an Anglo-German clearing office. Its object would be to ensure that there would be no transfer of British money to Germany until exports to that country had been paid for and the claims of British holders of Dawes and Young Loans had been satisfied. In a note to the German Government, the Foreign Secretary repudiated the arguments that had been put forward for the

inevitability of default, declaring that no less than Rm.767 millions of bonds (at gold parity) had been repurchased by Germany through the 'additional export' procedure up to the 28th February 1934.

'These facts inevitably give the impression that the policy of Germany is to claim that no foreign exchange resources are available to meet the service of her loans and then to apply the resources which should have been used in meeting that service to the repurchasing of her loans at the low prices resulting from default.'

Nevertheless, the British Government were prepared to discuss

'the possibility of reaching an agreement regarding the treatment of British creditors which would avoid the necessity of an exchange clearing altogether; or, alternatively, the means by which such a clearing could be administered with the minimum disturbance of the trade of both countries.'

The French Government announced on the 22nd June that they had decided upon the measures which they would take to secure the transfer of the Dawes and Young Loans service, should the German Government fail to make the necessary arrangements. It was estimated that the annual service of the French holdings of these loans required less than 150 million francs, whereas the import surplus of France's trade with Germany had exceeded 200 million francs in the first four months of the year. The American Ambassador had already presented a note to the German Government, protesting against discriminatory treatment among the different national creditors of Germany, and expressing the 'strongest regret' at the new losses imposed on American bondholders.

The balance of commodity trade between Germany and the United States was heavily in the latter's favour, whereas most of the other chief creditor countries (including Great Britain, France, Switzerland, and the Netherlands) had passive balances in their trade with Germany. By contrast, 40 per cent. of Germany's long-term debt (amounting to Rm.7,440 millions in September 1933) was held in the United States, compared with 21 per cent. held in the Netherlands,

14 per cent. in Switzerland, 11 per cent. in Great Britain, and 6 per cent. in France. Great Britain, with an import surplus of over £15 millions in her trade with Germany in the year ended the 31st March 1934, and with a total debt service of less than £5 millions per annum due to her, was clearly in a good position to exact financial favours. On the other hand, German spokesmen retorted that the Reich's balance of trade with the British Empire as a whole showed a considerable import surplus in favour of the Empire.

The Debts Clearing Office and Import Restrictions Reprisals Bill was introduced into the House of Commons on the 20th June. Its first clause empowered the Treasury to set up a clearing office against any foreign country from whom payments or transfers to United Kingdom residents were subjected to restrictions or were prohibited or had been discontinued. All payments for imports from that country would have to be made through the clearing office, which would employ the sums received to discharge debts due from persons in the foreign country. The second clause empowered the Board of Trade to prohibit or restrict the importation of goods of any specified class or description produced in or consigned from any country that imposed quantitative restrictions on imports from the United Kingdom or the non-self-governing colonies. The Chancellor of the Exchequer later explained that the second clause had no special relation to the German default, but that the opportunity had been taken to acquire a necessary tariff-bargaining weapon.

The Bill was passed on the 28th June, but meanwhile negotiations had been proceeding in London between representatives of the two Governments for the avoidance of the exchange clearing device. Their successful conclusion was reported on the 4th July. The German Government agreed to provide, during the six months ending the 31st December 1934, sterling funds at the Bank of England for the purchase at full nominal value of all coupons of the Dawes and Young Loans which had been in the beneficial ownership of British holders on the 15th June. The terms of the Reichsbank's offer of the 29th May were to apply to all British holdings of all other medium- and long-term debt of Germany, provided

that, if more favourable terms were accorded to any other creditor country, Great Britain could claim equivalent treatment, taking into account all the circumstances, including any special advantage that Germany received from the other creditor country. During the period of the agreement the British Government undertook not to exercise in respect of Germany the powers given in the Clearing Office Bill.

No sooner was the problem of the Reich loans out of the way for the moment than the problem of Germany's commercial debt came to the fore. It had been raised in the course of the London negotiations, and on the 10th August an exchange agreement was signed in Berlin. It applied only to future transactions, and had no reference to outstanding commercial debts. It provided that if insufficient foreign exchange was allotted to pay in full for goods imported from Great Britain or other parts of the British Empire, the difference might be paid at the option of the trader into a special account at the Reichsbank. These special Reichsmarks, or 'Sondermarks', as they came to be called, would be sold by the Bank of England, as opportunity arose, for the credit of the British exporters to whom the debts were due. As soon as the special account reached a total of Rm.5 millions no further payments into it would be accepted. Sondermarks could be used for practically every purpose inside Germany, but could not be transferred outside. Such was the difficulty in disposing of them on the London market that the limit of Rm.5 millions was reached a month after the arrangement began. In order to facilitate their sale, arrangements were made for dealing in forward Sondermarks, and the list of purposes for which these marks could be used was widened. Although the President of the Board of Trade appealed to importers and others who had payments to make in Germany to use the Sondermark account as much as possible, by the end of October the total awaiting transfer in and outside the account exceeded Rm.19 millions.

Meanwhile, equally serious difficulties had arisen in connexion with Germany's outstanding commercial debts. At the beginning of August, Lancashire yarn exporters had decided to cease exports of yarn to Germany until outstanding

debts had been met, and the Association of Bradford Export Merchants protested against the conclusion of the exchange agreement of the 10th August without a settlement of outstanding debts. An official delegation left for Berlin on the 17th September, prepared to negotiate on the question of outstanding debts as well as on that of the future of the August agreement. A comprehensive accord did not emerge until the 1st November. The accord provided, first, for the prolongation of the transfer agreement on long-term debt (including the Dawes and Young Loans) after the 31st December, but with the rate of interest on the funding bonds raised from 3 to 4 per cent. Outstanding commercial debts would be liquidated within twelve months. For this purpose there would be made available an immediate cash payment of not less than £400,000, together with the proceeds of outstanding German claims in London, and, if necessary, a percentage (provisionally fixed at 10 per cent.) of the value of German exports to the United Kingdom. The Sondermark account was to be liquidated within three months. Germany agreed not to impose further restrictions on imports from Great Britain at the outset; later she might do so, after consultation with the British Government, but only with the latter's consent could such restrictions be applied to coal and coke, herrings, yarn, tissues, or textile manufactures. Germany further undertook not to reduce the proportions of German imports of raw materials and foodstuffs coming from (or by way of) the United Kingdom or the British colonies. The parties had also initialled an exchange clearing agreement which should come into force automatically if the 'liquidation pact' should be denounced. The agreement was greeted with approval by British exporting interests, and the ban on yarn shipments was thereupon raised. A month later it was announced that the Bank of England had granted the Reichsbank a credit of £750,000 in order to expedite the liquidation of outstanding commercial claims. The credit was understood to have been made against the discount of German commercial claims on United Kingdom importers.

The conclusion of the Anglo-German agreement was followed by the dispatch of a note to Germany by the United

States Government, protesting against 'inacceptable and dangerous' discrimination against United States holders of German bonds. The note declared that the principle that debts should be paid only from the proceeds of direct sales to the creditor country was

'dangerous as dislocating the relations between debtor and creditor, and tending to establish a new principle that any international debtor can, in effect, repudiate all or part of the indebtedness that could be paid from the exchange derived from triangular or multilateral trading.'

The story of Germany's 'standstill' debt in this period was very different from that of her long-term and commercial external debt; for the Standstill Agreement was working smoothly and satisfactorily. When the conference between the Debtors' and Creditors' Committees was held in Berlin in February 1935, the main points for consideration were the German claim for a reduction of interest rates in accordance with the general cheapening of money, and the creditors' demand for a cut in the 'unavailed' portions of the outstanding credits. These unavailed credits, which represented contingent undertakings to furnish rediscount facilities to the creditors' German clients, had increased in volume in 1934 owing to the fall in Germany's foreign trade, and at the beginning of 1935 they amounted to no less than Rm.283 millions, or 13·7 per cent. of the total standstill credits. There was also the problem of credits guaranteed by the Golddiskontbank. Recognizing the transfer difficulty, the creditors had agreed in 1933 to the postponement of payment under these guarantees,[1] and the German authorities naturally pressed for a renewal of this concession.

A new Standstill Agreement was signed on the 16th February 1935. There was to be a general reduction of interest, amounting to ½ per cent. on the greater part of the credits, but owing to the special conditions prevailing in Switzerland the Swiss banks were not asked to accept this reduction. Creditors were authorized to cancel up to 50 per cent. of any credit line that had been unused for two years. While it was recognized that the resumption of Golddiskontbank payments was not

[1] See above, p. 112.

practicable, the guarantees might be liquidated by being offset against cancelled unavailed lines, and creditors who released Golddiskontbank guarantees might cancel a corresponding unavailed portion of other lines. In the ten months ended December 1934 the total of credits covered by the agreement had fallen by over Rm.500 millions to Rm.2,007 millions. The creditors, in their report on the conference, noted the deterioration in Germany's external trade position, for which they laid considerable blame on the various clearing and compensation agreements. On the other hand, there had been a considerable improvement in Germany's internal economy, and in the liquidity of German banks and other firms. The report added:

> 'The position of many debtors shows, therefore, a remarkable improvement, so that the problem of the liquidity of debts in general has for the time, at any rate, more or less ceased to exist.'

The complexity of financial detail involved in the problem of Germany's external debt did not disguise the fundamental issues that the problem raised. Germany's claim that resources for debt service were simply not available in 1934 could be justified by direct reference to the figures of her foreign trade. In only three months of 1934 did she achieve export surpluses, and these were completely swallowed up in the import surpluses of the rest of the year. On the other hand, the creditors could claim, with equal support from German official figures, that little or no effort had been made by Germany to adjust her economy to the necessity of finding through her external trade the means of paying her creditors. Whereas in France wholesale prices fell by 15 per cent. in 1934 (December to December) and even in Italy they were at the same level at the beginning as at the end of the year, in Germany they rose by 5 per cent. Such a consequence was doubtless to be expected from the increase in the note circulation, which rose by Rm.255 millions to Rm. 3,888 millions, largely by reason of Government expenditures financed by various forms of disguised short-term credit. Partly as a consequence of this monetary expansion, domestic trade increased considerably. The index of retail trade rose by 6 per cent. (January to

January), and that of industrial production by 18 per cent. The motor-car and the building and construction industries showed particularly striking advances. In the interest of internal revival, Germany sought to reduce to a minimum her economic connexion with the rest of the world. But signs that the minimum was already being approached were to be found in her inability to curtail appreciably her imports of raw materials, and in the pressure that the foreign exporters of such industrial necessities were able to put upon her to concede their financial claims.

Hence, it was for economic as well as for equally obvious strategic reasons that Germany made persistent efforts to promote 'the economy of substitutes' (*Ersatzwirtschaft*). The development of synthetic substitutes for raw materials—such as rubber and textile fibres—though receiving the most publicity abroad, was not so important economically at this stage as the reclamation of outworn and scrap material (rubber, metals, rags, paper), the development of unexploited domestic resources (notably certain tin and iron mines), the import of raw materials at their primary stage instead of partly manufactured (e.g. raw wool and cotton instead of yarn, bauxite instead of bar aluminium), the growth of crops like soya beans previously little known in Germany, and the substitution of materials obtainable in Germany for those which had to be imported. An example of the last kind of measure was the use of aluminium instead of copper; in August 1934 the use of copper for high-tension transmission cables was banned by decree.

The uneconomic character of these devices was shown by the necessity of still stricter control over imports in order to withstand the pressure to buy abroad. On the 24th September a new and more stringent régime was introduced. The system of control boards for imports was extended from a limited number of raw materials to all imported commodities. These control boards replaced the former exchange boards in regulating the allotment of foreign exchange, and the system of proportionate exchange rationing thereupon ceased. The Ministry of Economics was given unlimited powers to regulate the internal distribution of imported products. The control

boards could issue exchange certificates, without which imports could not be paid for, though they would not be illegal. The Ministries of Food and of Economics and the Reichsbank could from time to time jointly determine the amount of exchange certificates to be issued. Thus the external value of the reichsmark became more artificial than ever. 'It means', we may imagine Dr. Schacht saying as he sat on the wall of tariffs, quotas, and exchange restrictions, 'just what I choose it to mean, neither more nor less.' The 'great fall', however, in the shape of a devaluation of the reichsmark, did not occur, though it was frequently predicted at this time. The practical cessation of payments on Germany's external debt relaxed one of the main influences behind Germany's policy of maintaining the exchange value of the reichsmark. On the other hand, the increasing stringency of Government control of foreign trade made it the less necessary to depreciate the mark in the interests of traders; for if exports and imports approximately balance, and all are under the hand of the Government, the nominal values at which the transactions are concluded become of minor importance, and the need for keeping cheap the imports of raw materials balances, if it does not outweigh, the need for making cheaper the exports of finished products.

(e) *Three South American Countries*

Argentina.

On the 29th December 1929 the Argentine Republic deserted the gold standard. The reserves of gold in the Currency Conversion Office were at that time ample, and Argentina was widely criticized for suspending convertibility without the plea of urgent necessity. On the other hand, the balance of trade showed a heavy deficit, large sums of money were being sent abroad in anticipation of an eventual fall of the peso, and the Government could point to the desirability of forestalling the exhaustion of reserves which might be vitally necessary at some future date. In 1930 and 1931 the peso depreciated by fits and starts, until at the time of Great Britain's suspension of the gold standard it was quoted at \$18·6 (paper) to the pound sterling, compared with a par rate of \$11·45. Although a credit balance of commodity trade was achieved in 1931,

gold to the value of £34 millions was exported. The degree of internal deflation may be gauged from the fall in the volume of bank deposits from 4,029 million pesos at the end of 1930 to 3,555 million pesos at the end of 1931.

The fall of the pound was a very serious matter for Argentina, since Great Britain was her best customer, one of her principal suppliers, and an investor to a total of some £300 millions in Argentine enterprise and Government bonds. The peso fell sharply in September and October 1931, till the premium on gold-standard currencies exceeded 80 per cent. On the 10th October the Provisional Government issued a decree establishing an Exchange Control Commission to regulate all exchange operations and to fix daily rates for the purchase and sale of exchange. The Commission acted tentatively at first, but later it virtually pegged the peso to the United States dollar. When the latter went off the gold standard in March 1933 the gold franc became the anchor for the peso. At the end of November 1932 a special advisory committee appointed by the Government to consider the working of the exchange system had recommended

'that through the [Exchange Control] Commission there should be initiated a policy of commercial reciprocity with those countries which purchased Argentine exports; and that for this purpose the available exchange ought to be distributed, after satisfying the needs of the National and Provincial Governments, amongst the drawers of drafts according to the destination of remittances, in order that each foreign country should receive a quantity of exchange approximately proportionate to the amount of Argentine produce which it had received during the previous year.'

This principle was embodied in the Anglo-Argentine Agreement of the 1st May 1933 (the Roca Convention), Article 2, paragraph 1, of which ran:

'Whenever any system of exchange control is in operation in Argentina the conditions under which foreign currency shall be made available in any year shall be such as to secure that there shall be available, for the purpose of meeting applications for current remittances from Argentina to the United Kingdom, the full amount of the sterling exchange arising from the sale of Argentine products in the United Kingdom after deduction of a

reasonable sum annually towards the payment of the service of the Argentine public external debts (national, provincial and municipal) payable in countries other than the United Kingdom.'

The same principle was applied in subsequent agreements between Argentina and Belgium, Holland, and Switzerland.

At the end of November 1933 the Argentine Government decided upon a new exchange policy. All except a small percentage of foreign exchange arising from export drafts was to be surrendered to the Exchange Commission at artificially fixed rates; and the Commission was to sell exchange by tender to importers and others in possession of remittance certificates. The margin between buying and selling rates would furnish a fund which was intended to cover losses incurred by the Grain Regulation Board in the purchase of grain at fixed minimum prices. Foreign exchange not compulsorily surrendered to the Commission could be bought and sold in a free exchange market, where it commanded a considerable premium over the tender rate. The average exchange profit gained by the Commission was about 12 per cent. on the turnover, or about $2 per pound sterling. In the first ten months in which the new law operated, the Commission's profit totalled $91,200,000, to which there could be added some $5 millions gained by the Government in their transactions on the free-exchange market. Out of these profits $24,600,000 were allotted to the Treasury for exchange losses on remittances for debt service and other purposes, $8,800,000 went to meet the losses of the Grain Regulating Board, and $1,700,000 were distributed to producers by the Dairy Industry Regulating Board to compensate for the low prices that they had received throughout the year. The balance of the profit remained unallocated, and the Government had also acquired a surplus of $71,900,000 in foreign currency which was being utilized as an exchange equalization fund. This accumulation of foreign exchange incensed those who had been unable to obtain sufficient for their requirements.

The small amount needed by the Grain Regulating Board belied all forecasts made when the new system was introduced. The drought in the United States was of very great assistance to the Argentine grain trade, and the price of wheat in pesos

rose by 62 per cent. between November 1933 and the following August. The Argentine wheat crop was also above expectations, a fact which hindered considerably the operation of the International Wheat Agreement. During this same period the price of maize was nearly doubled. Later there was a recession, but from the middle of 1933 onwards the Grain Regulating Board was probably able to make a profit on the majority of its operations. Expressed in Argentine currency, the prices of wool and mutton also rose, in 1934, by a greater proportion than would in any event have been expected to follow the depreciation of the currency. The only products among Argentina's principal exports to show a fall of price were butter and frozen beef. Her total export trade showed a rise of 10·7 per cent. in volume compared with 1933, and a rise of 28·3 per cent. in value. Imports increased by 6·2 per cent. in volume and 23·7 per cent. in value, and the surplus of exports over imports rose from \$223 millions to \$328 millions, over 80 per cent. of which arose out of trade with Great Britain.

The exchange policy initiated in November 1933 thus appeared to have been of service to Argentina, both in improving her balance of payments and in relieving internal conditions. Credit became easier, money circulated more freely, and the Budget showed a small surplus in place of the 1933 deficit. At the same time it must be recognized that Argentina had gained considerably by changes in world conditions that were outside her direct control. In 1935 Argentina proceeded with the establishment of a central bank and the rationalization of her currency and exchange system. The new institution took over the functions of the Exchange Control Commission and the assets of the Exchange Profit Account and of the Foreign Currency Fund. The central banking law contemplated the eventual return of the peso to the gold standard, the maximum depreciation allowed being equivalent, with gold at 140*s.* an ounce, to a parity of \$15·35 to the pound. The system of fixing a price for export bills well below the price charged for exchange to importers continued, the maximum margin to be 20 per cent.

It was announced on the 1st June 1935 that the gold stocks

of the Argentine Central Bank were to be revalued at the rate of 25 pesos to the gold pound, equivalent, at the existing price of gold in London (approximately 142*s.* an ounce), to about \$15 to the paper pound. The open-market rate for Argentine pesos at that date was \$18·7 to the pound, while the official rate was \$15 to the pound.

Brazil.

The economic career of Brazil was closely bound up with the market for coffee, which even after the collapse of prices constituted no less than 70 per cent. of her exports. Between 1921 and 1929 the Government pursued a policy of maintaining an artificial price for coffee by holding stocks off the market. As a result, however, production was stimulated, and a series of abnormally large crops was followed by the total collapse of the world coffee market. The price of coffee in the United States, the principal consuming country, fell from 24·8 cents a pound in March 1929 to 7·6 cents a pound in October 1931. The Brazilian Government were left with vast stocks of coffee which they could not sell, and they were forced to adopt a policy of destroying the coffee in the warehouses, financing the operation by a tax on raw coffee. By the beginning of 1934 some 26 million bags of coffee had been burned, and the price, as a result, improved considerably. But the prospect of a record crop in 1933–4 caused a sharp recession, and in April 1934 coffee-burning was resumed. The collapse of the coffee market in 1930 naturally caused severe trouble in two main fields—public finance and the balance of external payments. The aggregate deficits of the Federal Government from 1930 to 1934 inclusive exceeded 3 million contos of reis. Exports fell by nearly one-third in local value in a single year (1929 to 1930), but imports declined equally sharply, and the surplus of exports, expressed in Brazilian currency, actually rose. Milreis, however, had depreciated, and the burden of foreign debt service was proportionately increased.

When, at the end of 1930, Senhor Vargas became dictator, the gold reserve was almost exhausted. In September 1931 all foreign exchange transactions were placed under the control of the Bank of Brazil, and a few weeks later a three-

year moratorium was declared upon all the external debts of the states and counties and of the Federal Government, except two funding loans and a coffee loan which had been specially secured. In February 1934 a new debt scheme was promulgated. Government bonds were divided into eight categories, ranging from the funding loans of 1898 and 1914 and the funding bonds that had been issued in lieu of cash for debt service under the 1931 scheme, on which full interest and sinking fund was to be paid, to a Cinderella group which was to receive neither interest nor sinking fund. The balance not paid in foreign currencies would have to be paid by the various governmental debtors in milreis, which would be available for relending to the Government. If the foreign exchange resources available were more than enough to pay what was due under the scheme, the balance would be applied to purchasing bonds below par. The scheme was imposed over the protests of bondholders. In January 1935 funds were not forthcoming in London for the service of certain loans, which fell due at that date under the scheme, but a fortnight later the sums payable were transferred and the scheme returned to normal operation.

Considerable difficulties had also arisen over the settlement of outstanding commercial debts. In March 1935 an agreement was signed between the United Kingdom and Brazilian Governments for the liquidation of these debts; the latter Government undertook to set aside for payment of commercial debts £1,200,000 annually out of the percentage of foreign exchange reserved for the Government.

Meanwhile changes had taken place in the Brazilian exchange system. The system initiated in September 1931 was similar to that enforced in Argentina, but it differed in important particulars. Only 89 per cent. of export bills arising from the sale of coffee, and 25 to 50 per cent. of the bills arising from the export of other products, had to be sold to the Government, which used the proceeds for debt service and for sale at a cheap official rate to selected importers. The remaining export bills could be sold at a limited premium on the 'grey' market. There was also an illegal 'black' market, where exchange urgently required could be had at a high

premium, but in May 1934 the 'black' exchange market was whitened by official recognition, and later in the year the free market was further benefited by the release of a larger proportion of export bills from Government control. At the beginning of December 1934 the Bank of Brazil announced that, since exchange for the official market was derived at that time entirely from coffee exports, exchange on that market would be allocated in proportion to the purchases of Brazilian coffee made by the different countries. Under this arrangement, the United States would receive 46 per cent. of the exchange available. Great Britain, though adversely affected by this plan, could make no complaint against its principle, in view of the similar terms of the Roca Agreement with Argentina. Two months later Brazil concluded a trade treaty with the United States under which both countries reduced tariffs on each other's products, and Brazil undertook to provide exchange in full for all future imports from the United States, to pay the service on the funding notes representing blocked debt service, and to apply any balance of dollar exchange to the liquidation of outstanding indebtedness.

While the United States was by far the greatest consumer of Brazilian coffee, the growing diversification of Brazil's exports tended to diminish the relative importance of the United States in the total export business of the country. One of the most important alternative crops was cotton, and in the export of raw cotton Brazil achieved an important advance. Whereas the gold value of coffee exports fell from £26,168,000 (gold) in 1933 to £21,541,000 in 1934 (reckoning the pound at its pre-1931 gold parity), the gold value of cotton exports rose from £369,000 to £4,667,000. The latter product was marketed mainly in the United Kingdom, where it replaced American cotton. The aggregate gold value of all exports was barely changed in 1934 compared with the previous year, while imports fell by very nearly £10 million (gold). Under the régime of a low exchange rate and comparatively liberal credit conditions at home, Brazilian manufacturing industry was prosperous and expanding.

Chile.

The dependence of Brazil on coffee, and of Argentina on wheat and meat, was matched by Chile's dependence on nitrate and copper. Not merely her external balance of payments but her whole social and economic equilibrium rested upon the production of these two commodities; for the opportunity of industrial employment in the mines or on the nitrate fields was an irreplaceable safeguard against agrarian revolt in the central, agricultural part of Chile. Most of the agriculture, together with the government of the country, was in the hands of a few large landowners. Thus to the collapse of nitrate and copper prices must be ascribed not only the direct financial and economic difficulties of Chile but also the series of revolutions and counter-revolutions between the overthrow of President Ibáñez in July 1931 and the election of President Alessandri in October 1932.

The troubles of the nitrate industry originated, long before the slump, in the rapid development of synthetic nitrogen production, an industry fostered by Governments as an engine of war as well as for reasons of economic nationalism. At the same time, Chile's own productive capacity was increased by the introduction of new capital from the United States and the construction of the two great Guggenheim plants, the Maria Elena and the Pedro de Valdivia. World productive capacity for nitrates approached 4 million tons per annum, whereas consumption, even in 1929–30, did not exceed 2 million tons. Hence the world slump only precipitated and exaggerated a collapse that was already inherent in the position of the nitrate industry. Chile's nitrate production, which in 1924–5 had been valued at over £23½ millions (gold), was worth less than £2 million (gold) in 1932–3. On the 21st July 1930 the Ibáñez Administration established by law the Companía de Salitre de Chile (known generally as 'Cosach'). This corporation, whose shares were held partly by the Government and partly by the producing interests, acquired 95 per cent. of the country's productive capacity, including the Guggenheim enterprises, in whose plant it was intended to concentrate the treatment of nitrate. Besides gaining the benefits of rationalization the industry was to be

relieved of the burden of the export tax, one of the principal revenue items in the Chilean budget; the Government, in return, obtained shares in the enterprise and were guaranteed a minimum return during a transition period ending in 1933.

Cosach did not have a very successful career. No sooner was its formation complete, in August 1931, than the Government were obliged to declare a complete moratorium on their external debt, and in the spring of 1932 the service of all the funded debt of Cosach was suspended, except certain prior secured bonds of an international loan. Meanwhile public outcry had been raised in Chile against the new concern, on the grounds, *inter alia*, that the nation had sold its birthright for an inadequate consideration, that the value of the Guggenheim plant and process had been exaggerated, that watered stock had been acquired from the producing companies, and that rationalization would throw two-thirds of the nitrate workers out of employment. The Alessandri Government came into office pledged to dissolve Cosach, an act which they immediately performed. In January 1934 a law was passed establishing a Chilean Nitrate and Iodine Sales Corporation, which was granted for thirty-five years the monopoly of buying nitrate and iodine from the producers and selling and distributing them in world markets. Five directors were to represent the Government and five the producing companies, while the President of the Corporation was to be elected by these ten voting together. The price paid for nitrate was to be the direct cost (i.e. omitting all capital charges) plus U.S. $1·50 per ton. The Government were to receive a quarter of the profits, in return for which they would forgo all export duties and all income tax or other taxes on the producers. Of the remainder of the profits, not less than 20 per cent. was to be appropriated, in the initial stages, for paying off bank debts secured on old stocks of nitrate. The next charge was service on the bonds of the defunct Cosach, which were also to receive for extraordinary amortization 30 per cent. of the remaining profits, the residue going to the producing companies. In 1933–4, however, when profits of £1,286,252 were recorded, the whole of the companies' share went to pay off

a debt of 140 million pesos due to the state from Cosach in respect of the year 1933.

A satisfactory scheme of financial and marketing organization having thus been found by the Chilean nitrate industry, its next problem clearly was to secure an international agreement with the synthetic producers. The Paris Agreement of July 1934, which has been described in an earlier chapter, provided for a sliding scale of prices fixing the price-relation between synthetic and Chilean nitrate, and also for the allocation to Chile of a share in certain European markets.

After the entry of the Guggenheim interests the ownership and control of the nitrate industry in Chile had been shared between British and American capital. The copper mines, on the other hand, were almost exclusively in the hands of the United States interests, chiefly the great companies mining and smelting copper in the United States itself. The history of the Chilean copper industry during the depression is a facet of the history of world trade in copper. Apart from the general collapse of prices, two changes struck particularly hardly at Chile—first, the virtual closing of the United States market, the natural market for such American-owned copper production, by the imposition of an import duty of 4 cents a pound; and, second, the rapid rise of the African copper industry. The international restriction agreement concluded in March 1935 opened up for Chile the prospect of very profitable copper production, at the price of a cut of one-third in the output of the mines.

Between October 1928 and the middle of 1931 the gold reserves of the Chilean central bank fell from 615 million to 195 million pesos. On the 18th August 1931 Chile declared a complete moratorium on her foreign debt, and payments had still not been renewed at the end of 1934, by which time the arrears of interest approached a total of £20 millions. Meanwhile, the foreign trade position had improved considerably, partly through a revival of export values, partly through a remarkable economy in imports. The export surplus in 1934 was 272 million pesos (gold). Foreign exchange was subject to official control under a régime not unlike those of Argentina

and Brazil. At the beginning of 1935, as a step towards a freer exchange system, the official exchange rate was lowered from 3*d.* (gold) per peso to $1\frac{1}{2}$*d.* (gold), the latter rate corresponding to 94 pesos to the pound sterling, against a rate of 117 pesos ruling in the 'barter' market. The ratio between the latter rate and the par rate of 40 pesos indicated the effective depreciation of the Chilean peso at that time. Chile's foreign exchange situation was rendered the more stringent by a series of 'compensation' agreements entered into with eleven European countries, appropriating part of the proceeds of Chile's exports to those countries for the redemption of outstanding commercial debts. The Bill for the resumption of service on the public debt, which was passed at the beginning of 1935, provided that the whole yield of taxation on the copper mines, together with all the Government's share of the profit on sales of nitrate and iodine, should be handed to the Caja de Amortización, one-half to be used to pay interest and the other half, less certain expenses, to be applied to sinking fund. The measure was greeted with much criticism by the bondholders; they objected on principle to such unilateral treatment of the debtor-creditor problem, and they complained that moneys due to bondholders were being used to buy up, at bargain prices, bonds which had depreciated on account of the default itself.

Meanwhile the internal condition of Chile had shown a remarkable revival, and the British Commercial Secretary at Santiago could write, towards the end of 1934: 'There is no unemployment problem in Chile to-day.'

The economic experiences of the three South American republics which have been considered were uniform in many general respects. All had borrowed heavily in the pre-slump years, all found difficulty in meeting their external commitments after the prices of their exports had collapsed, and all managed to establish export surpluses which progressively improved their capacity to pay. Argentina did not default on her public long-term debt, and Brazil's default was not complete, but even the former achieved that record only by stringently checking remittances in foreign exchange by the railway companies and other commercial enterprises. All

three countries gained by the depreciation of the pound and the dollar against gold, which lightened the real value of their obligations expressed in those currencies. The depreciation of their own currencies, not only against gold but even against sterling, enhanced the local (that is, the budgetary) cost of their external debt service, but at the same time it helped to right their balance of payments by handicapping imports and promoting exports. At the beginning of 1935 their currencies were depreciated in the following degrees against their sterling parities: the Argentine peso by 42 per cent.; the Brazilian milreis by 45 per cent.; the Chilean peso by 65 per cent. (These, of course, were the unofficial or open-market rates.) Each of the three countries had signed bilateral commercial treaties with foreign countries based on the principle that only he who buys can be allowed to sell (or to be paid for past sales or past investments).

It is interesting to note that the internal and external economic revival of these three South American countries began before any substantial rise was apparent in the prices of their principal products as expressed in sterling. It was not until 1934 that there was any appreciable rise in the prices of wheat or coffee or nitrates; even at that date the price of beef was still falling, and the prices of copper and wool were receding after an improvement in the previous year. Such recovery during a régime of continued low prices may be attributed to four main causes—a great economy in costs of production, a tightening of the belt against the appetite for imports, a greater diversity of primary production for export, and an expansion of home industries.

(f) *Japan and World Trade*

As the world depression deepened, the mutterings of Japan's commercial competitors against the expansion of her trade swelled into clamour. It must not be supposed, however, that in a sudden campaign of commercial aggression she took the world's markets by storm. The record of her external merchandise trade in the first four years of the depression was as follows:

(In millions of yen)

	Imports	*Exports*	*Balance*	*Gold value of the yen* (1925=100)
1925	2,487	2,242	−243	100
1930	1,680	1,518	−162	120
1931	1,319	1,179	−140	119
1932	1,524	1,457	−67	68
1933	2,018	1,932	−86	49

It will be seen that both imports and exports increased by about 500 million yen in 1933. In gold values, there was actually a fall of 6 per cent. in Japan's total trade, and the proportion that her exports bore to total world trade, calculated in gold values, varied little from 1929 to 1933. If, however, the figures of her external trade are adjusted according to the movement of Japanese wholesale prices, there appears to have been an increase of about 16 per cent. in the volume both of imports and of exports between 1932 and 1933—at a time, of course, when world trade as a whole was still stagnant.

Cotton textiles formed a large part of the increased exports, but many other manufactures were being sent in growing quantities to markets all over the world. Almost every industrial country, whether its tariffs were high or low, raised some complaint against Japanese competition. The Union of South Africa, in August 1933, imposed special anti-dumping duties, on a penal scale, against certain classes of Japanese goods, including men's and boys' hats, bottles and jars, and matches. In Germany Japanese cloth was being sold at little over half local prices. Grey cloth was said to be offered by Japan in Norway at prices covering only the cost of yarn when imported from Lancashire. Japanese prices for many articles sold in the Belgian Congo were reported to be 30 to 50 per cent. below Belgian prices. Imports from Japan into 'Irāq rose from £98,000 in 1930–1 to £425,000 in 1932–3. In Great Britain, newspapers published lists of extraordinarily cheap articles of Japanese origin displayed for sale—men's socks at 3*d*. and 4*d*. a pair, khaki shirts at a wholesale price of 22*s*. 6*d*. a dozen, or a set of toy soldiers at 6*d*., with 'a tent flying the Union Jack'.

What fierceness of fire did this smoke betray? Among many popular explanations of the Japanese assault on world commerce, one of the most plausible was the depreciation of the yen. Certainly when Japan abandoned the gold standard in December 1931, after less than two years' painful trial, she enjoyed an extraordinary advantage, in that large stocks of raw materials had been imported cheaply when the exchange value of the yen had been high, whereas her exports now fetched a much better price expressed in yen. When those stocks were exhausted, however, Japanese costs, in the way of raw cotton and other imported materials, were inflated by the depreciation of the yen as much as were the prices of her finished products. Internal costs, like wages, did not rise proportionately, since Japan was largely self-supporting in the necessities of life. Yet if there had been any prolonged under-valuation of the yen, it would presumably have displayed itself in a more favourable balance of trade. This, in turn, would have been followed by upward pressure on the yen unless there were compensating payments abroad—for instance, exports of capital. Japan's balance of trade, on the contrary, deteriorated in 1933, nor, apparently, were special efforts required to hold the yen down to its low exchange level. Her imports rose in 1933 by as great a proportion as her exports. In brief, her ability to sell enhanced her capacity to buy. It is probable, however, that she obtained a much larger credit balance from invisible transactions in 1933 than in 1932, and this was absorbed by capital exports, mainly to Manchukuo.

Other commentators mentioned Japan's rapidly increasing population, pent within a group of mountainous islands, as the urge behind the expansion of her exports. While indeed the growth of population, and the difficulty of extending the area of agricultural land, may have imposed on Japan an economic system in which large-scale industrial exports played an essential part, it could not by itself squeeze exports out of her, like water from a saturated sponge. More cogent was the argument that Japan's growing population kept down the standard of life, and that her competitors had therefore to contend with exceptionally low wages. Figures were quoted

to show that wage rates in Japan were in fact far below those ruling in Western countries—for instance, that the average wage of a female operative in a silk filature was equivalent to a little over 9*d.* a day. Such arguments provoked not always quite relevant retorts, to the effect that the Japanese workers were well housed and fed, and were very comfortably off according to their lights.

The increase of the population, the fall of the yen, the lowness of wages when converted from a depreciated currency, the efforts of industrial management to cut costs, all fitted into a single logical system. Industrialization and a great natural increase marched together in twentieth-century Japan as they had in nineteenth-century Europe. Agriculture, especially when organized on a subsistence basis, can rest content with home markets; large-scale industry never. The quest for profits is bound to become a quest for further markets if only to consume at cut prices the surplus production that the home market cannot absorb. Industry demands raw materials, many of which, in Japan particularly, have to be bought abroad; and it raises the standard of life so that more consumable goods are imported also. Once Japan had adopted Western industrial technique, she was compelled to sell and she was compelled to buy. When it became impossible, with the yen at its gold parity, for her to sell as much as she required to pay for her essential purchases, the exchange was bound to fall. The lowness of Japanese wages, calculated in other currencies, measured not so much her capacity to export as her need to do so.

Undoubtedly, there was a more subtle urge besides this economic necessity. Like the Manchurian adventure and the later invasion of North China, Japanese commercial aggression sprang from psychological motive as well as material requirement. The World Economic Crisis found Japan in a mood of fermenting nationalism. In expanding exports, as in territorial aggrandizement, national pride found both ambition and self-flattery.

Japan was also sometimes accused of unfair competition, by means of dumping and of Government assistance to industry. On this point the testimony of the Commercial

Counsellor to the British Embassy at Tokyo may be cited.[1] 'There is no question', he wrote, 'of selling at below production cost, nor is there any evidence to show that goods for export are usually sold cheaper than goods for the domestic market.' Government subsidies to private industry, he reported, amounted to about £2 million per annum, of which over £1 million went to shipping.

'The assistance given to industry by the state in terms of money is of comparatively modest dimensions; and the principal form of Government help is probably protection by import tariff. Apart from such measures, however, the Japanese Government is not backward in taking positive steps to direct the course of industry and trade by legislation. . . . The progress of cartels and similar forms of jointly controlled activity has been very marked during the past few years. . . . The leading feature of industry in Japan in the period under review is its progressive "rationalization". In most of the important manufactures there was a serious and on the whole successful effort to improve organization and technique, to economize labour and to reduce costs.'

These were scarcely times to welcome a sharpening of the blade of international competition. Yet it should be noted that Japan's imports increased to the same tune as her exports, and that both alike were hostages to internationalism. Moreover, through the many-angled complex of world trade, the increase of Japan's external trade often turned to the eventual advantage of her competitors. Thus Australia, selling more wool to Japan, was able to buy more manufactures from Great Britain. One more point may be mentioned in refutation, or mitigation, of the case against Japan as the *sabotageur* of international commerce. In the long run, many of her new exports, especially those to 'native' territories, might well prove not to be competitive with European products, in that their cheapness appealed to a range of consumers whose wants would otherwise have gone unsatisfied. The populations of many tropical territories found their simple standard of life supported or even improved during these lean years by their ability to buy cheap Japanese goods. Of the Netherlands East Indies, for instance, it was stated that frequently Japan's

[1] Department of Overseas Trade Report, No. 54, 1933.

'phenomenally low prices had enabled her to create a new market for the buying public, with which her competitors had no previous dealings'.[1]

This aspect of Japan's foreign trade was strongly emphasized by opponents of the British Government's action in restricting the import of Japanese goods into certain parts of the dependent Empire. The President of the Board of Trade announced on the 7th May 1934 that the Governments of the colonies and protectorates 'for which such action would be appropriate' would be asked to introduce import quotas applicable to all foreign imports of cotton and rayon goods, except in West Africa, where treaty obligations precluded differentiation in favour of British goods. Notice had been given to terminate the Anglo-Japanese treaty in so far as it granted most-favoured-nation treatment in West Africa, and action there would be limited to Japanese products. Heavy tariffs on such products, including certain articles besides textiles, were subsequently imposed in Nigeria, Gambia, and the Gold Coast. The Nairobi correspondent of *The Times* reported that East African opinion did not regret that similar action in East Africa was barred by the Congo Basin treaties.

> 'It is felt [he wrote] that the limited native purchasing power has been used, money circulated, and trade kept alive by Japanese goods at a critical time, which would have been less probably the case with more expensive British articles. An example of such indirect benefit comes from Tanganyika, where medical officers declare that the purchase of cheap Japanese rubber shoes has done more to prevent hookworm disease than all the efforts of the health department.'

In some colonies considerable local opposition to the anti-Japanese quotas and tariff manifested itself, and in Ceylon and the Straits Settlements the authoritarian powers of Government had to be invoked in order to carry the necessary measures.

In many ways India was the lynch-pin of Japan's external

[1] From a speech by the Chairman of the British Chamber of Commerce in the Netherlands East Indies.

economic system. Indian cotton played a considerable part in her raw-material requirements, while in India she found a great market for manufactures, especially cotton textiles.[1] The depreciation of the yen soon began to cause complaint; for the protective effect of the existing tariff was, for the time being, almost, if not wholly, nullified. The duty on foreign cotton piece-goods was increased by two stages, the second of them on the 6th June 1933, to 75 per cent. *ad valorem*; but action specifically against Japan was precluded by a Trade Convention of 1904, according mutual most-favoured-nation treatment. On the 12th April 1933 the British Foreign Secretary, on behalf of the Government of India, had given notice of the abrogation of the convention, to take effect six months later. The Indian Government had also passed a Safeguarding of Industries Act, designed to protect home industries against abnormal foreign competition, based, for instance, on exchange depreciation.

After two months' preliminary correspondence the Government of India invited the Japanese Government to send representatives to discuss the future of trade between the two countries. The opportunity was also taken to dispatch a delegation from Lancashire, under the chairmanship of Sir William Clare Lees, for discussions with the Indian and Japanese trade representatives. It was made clear, however, that the Indian Government could not negotiate with the Lancashire delegation, though it would treat their views as evidence. In no sense was Lancashire a party to the Indo-Japanese discussions.

An agreement between the Lancashire delegation and the spokesmen of the Bombay mill-owners was actually reached some weeks before the Indo-Japanese negotiations proved successful. It was agreed, *inter alia*,

'that the Indian cotton textile industry is entitled for its progressive development to a reasonable measure of protection against imports of United Kingdom yarns and piece-goods. It is also agreed that under present conditions, owing to lower costs and other factors operating in foreign countries, the industry re-

[1] In 1932 India took 28 per cent. of Japan's cotton exports, including two-thirds of her exports of cotton yarn.

quires a higher level of protection against them than against the United Kingdom.

'That any advantages which might be arranged for British goods in Empire and other oversea markets for piece-goods and yarns should be extended to Indian goods.'

The Indian parties would acquiesce in the exemption of United Kingdom goods from the general surcharge on all imports, imposed in October 1931, if and when the budgetary situation permitted. They would concur in the placing of duties of 5 per cent. on cotton yarns, and of 30 per cent. on artificial silk piece-goods from the United Kingdom (with corresponding specific duties). The British textile mission undertook to support effective action to popularize and promote the use of Indian raw cotton in the United Kingdom. This agreement would hold good until the 31st December 1935.

The negotiations with Japan meanwhile dragged on, from 'last word' to 'last word'. The expiry of the Indo-Japanese Trade Convention, which would have taken effect on the 10th November, was postponed by the Indian Government, as the talks were still in progress. There was agitation in Japan for a boycott of Indian raw cotton and the withdrawal of the delegation. This agitation was reinforced when the Government of India introduced a Bill to apply to certain classes of imports, mostly those in which Japanese competition was being keenly felt, a minimum specific duty alongside the existing *ad valorem* duty.

Despite these alarms, an agreement was reached on the 3rd January 1934. Japan secured the right to export to India a maximum of 400 million yards of cotton piece-goods under a 50 per cent. duty. That rate (and also the duties on other Japanese products) might, however, be varied to correct the effect of exchange fluctuations. In return, Japan undertook to accept proportionate quantities of Indian raw cotton; the first 125 million yards of piece-goods she might sell without obligation, but against the next 200 million yards she must buy a million bales of cotton, and against the next 75 million she must buy an additional half-million bales. Any excess purchases of cotton in any one year might be credited to the next year. The piece-goods quota was divided into four

categories, each being allotted a certain percentage, but a limited variation was to be allowed between them. The agreement, which was of three years' duration, accorded reciprocal most-favoured-nation treatment. Each party recognized the right of the other to safeguard its own industries, but both agreed that, should any tariff modification adversely affect the trade interests of the opposite party, they would enter into negotiations with the object of reconciling, as far as possible, their mutual trade interests.

In spite of the reduction of the standard rate of duty from 75 to 50 per cent., the agreement did not curtail the protection enjoyed by the Indian weaving industry; for the maximum allotment of 400 million yards of piece-goods was some 179 million yards less than India's imports from Japan in the previous fiscal year. To that extent the agreement might be counted an advantage to Lancashire also. The corresponding import of $1\frac{1}{2}$ million bales of Indian cotton was nearly 50 per cent. higher than the quantity bought by Japan in the previous fiscal year. It must be remembered, however, that in this business 1932–3 had been a quite abnormal year, and that since the end of the fiscal year the Indian tariff had been raised and the Trade Convention denounced; Japan had therefore to look forward to a possible big reduction of her exports to India. Highly dependent, as she was, on export markets, she accepted with some reluctance a bargain that from her point of view was doubtless disagreeably hard.

Important as the specific terms of the agreement were, they were not so important as the principles that were implied. For the first time in her career as a member-nation of the British Commonwealth, India had concluded an agreement with a foreign Power, on her own behalf, through her own representatives, and in her own capital. Again, the agreement was the first attempt to cope with Japanese commercial aggression by negotiation followed by deliberate regulation. Still more vital, this agreement between two great industrial nations embodied the principle of the quantitative quota, not as a means of meeting the crisis, but as a permanent instrument of economic policy, with all its necessary repercussions upon internal economic structure. The

Indo-Japanese agreement was thus far more than a bilateral bargain; it was an international portent.

Japan's balance of commodity trade deteriorated further in 1934. Exports rose in value by 306 million yen, compared with the previous year, but imports rose by 364 million yen. The increase in imports was due mainly to larger purchases of raw and semi-finished materials, notably cotton, wool, iron and steel, and petroleum. This was a natural result of the expansionary economic policy that Japan was pursuing internally. Apart from heavy military expenditures which were not covered by current taxation, a programme of public works—again largely of a military kind—was financed by loans. As a cure for the economic and financial stagnation that characterized Japan up to 1932 this policy must be counted successful. The price paid was an addition of some 3,000 million yen (say £200 millions) to the national debt in three years; the benefits purchased included a great expansion of production and an avoidance of large-scale industrial unemployment. The textile manufacturing industries, producing largely for export, were particularly prosperous. At the same time there were serious blots on this fair picture. The agricultural population—forming nearly one-half of the total population of Japan—suffered not only from miserably low prices for their crops but also, in 1934, from disastrous weather conditions, including a drought, a typhoon, and floods. The rice crop was less than three-quarters of the 1933 crop, and the cocoon yield fell by 16 per cent. The income of farmers from these two leading products was estimated to have fallen from 1,379 million yen in 1933 to 867 million yen in 1934. There was chronic unemployment in many agricultural areas, and thus manufacturing industry was furnished with a ready reserve of labour which kept down the level of industrial wages in spite of increased production. Indeed, the enlargement of manufacturing output was accomplished almost entirely by advances in efficiency.

'Such prosperity as Japan has lately enjoyed [wrote the Commercial Counsellor of the British Embassy[1]] has so far benefited only limited sections of the population. It has not been shared by

[1] *Economic Conditions in Japan.* (Department of Overseas Trade, May 1935.)

the agrarian class, and it has been of advantage to the workers in industry (apart from those in specially favoured trades—for example, certain export trades and those connected with the output of munitions) negatively by saving them from unemployment rather than positively by increasing their incomes.'

(g) *Conclusion*

If there is one clear thread running through the varying experience of groups of countries under different currency systems in this phase of world economic history, it is the divergence between internal and external trends. On one side there were countries like the United States, or New Zealand, whose internal economic problems seemed to have been little relieved by the expansion of their credit balance of external trade through the depreciation of their currencies. On the opposite side, there were countries of the gold bloc whose external trade difficulties were slight compared with the internal difficulties of their deflationary régimes. A third group, contrasting with both these, was composed of countries like the Union of South Africa or the United Kingdom herself, whose internal economy prospered on the strength of advantages derived from a depreciated exchange, but in face of a deteriorating balance of external trade. Akin in many ways to this group was Germany; for while her external trade difficulties rapidly thickened she enjoyed an internal economic revival. In her case, however, not only was the internal expansion based on governmental artifice rather than on natural recovery, but her commercial and financial relations with the rest of the world were likewise subjected to rigid official control, with the purpose of maintaining a nominal parity between the reichsmark and gold currencies.

Other countries whose experience it has not been possible to treat at length within the limits of this chapter may be brought into the same picture. Thus more than one country in Northern Europe found its internal economy expanding while the balance of its foreign trade moved adversely. In Denmark, for instance, while the import surplus was rising, agriculture became distinctly less depressed, the percentage of unemployment dropped from over 28 per cent. to 22 per

cent. between 1933 and 1934, and the index of home production rose by 9 per cent. during the year, chiefly as a result of increased building activity. Norway had a very similar experience. Sweden, on the other hand, reduced her import surplus and at the same time achieved a remarkable revival of internal industry, the index of production standing at the end of the year above the 1929 level; nevertheless a considerable residue of unemployment existed in the face of large supplies of idle capital. Among the countries of Central Europe, Austria had already effectively devalued her currency, with satisfactory results in the field of foreign trade, exports increasing to 863 million schillings from 748 million schillings in 1933, and the import surplus falling from 373 million schillings to 291 million schillings. Unemployment, measured by the numbers in receipt of state assistance, fell appreciably during 1934, but a very large part of the apparent improvement was due, as in Germany, to the exclusion of disfavoured persons from the relief roll, to the absorption of workers into 'private armies', and to the prosperity of munition manufacturing and associated industries. The index of turnover in consumers' goods fell in the course of the year, and there were other signs of internal economic trouble. In February 1934 the Government of Czechoslovakia devalued the crown by one-sixth, and followed this up with a number of measures designed to revive the credit market, protect the exchanges, and assist agriculture. There was an appreciable improvement in foreign trade—an import surplus of 202 million crowns in 1933 being turned into an export surplus of 890 million crowns in 1934—but the internal improvement was moderate and unemployment remained a serious problem. Bulgaria may be taken as representative of those European debtor countries which maintained a false external equilibrium by means of exchange regulation and cuts in debt service. Behind the barrier of exchange control Bulgaria artificially maintained the level of domestic prices by official monopolies and other means. The result was an improvement in the nominal incomes of primary producers coupled with a decline in the turnover of manufacturing industry, in exports, and in the active balance of foreign trade.

To the pattern of divergence between internal and external trends no country presented a striking exception (save, perhaps, Sweden), though not all provided equally decisive examples. The following table, showing the external trade experience of certain European countries of the gold bloc and of the sterling bloc in the five years ended 1934, illustrates both the main trend and the variations from it within each group.

It will be seen that between 1930 and 1933 the European sterling group's share in world export trade actually declined, while that of the gold group increased slightly. In 1934 both these groups increased their percentages, for several reasons, including the excellent European wheat crop, the difficulties of Germany and other countries of Central and Eastern Europe, and the fall in the price of wool. Nevertheless, the ratio between the exports of the sterling group and those of the gold group was appreciably lower at the end than at the beginning of the period covered by the table.

Exports as a Percentage of World Exports

(Based on gold values)

	1929	*1930*	*1931*	*1932*	*1933*	*1934*
Sterling Group:						
Denmark	1·31	1·54	1·67	1·58	1·46	1·44
Norway	0·51	0·68	0·58	0·78	0·80	0·80
Sweden	1·47	1·57	1·46	1·35	1·58	1·85
United Kingdom	10·74	10·48	9·37	9·91	10·37	10·97
Totals	14·03	14·27	13·08	13·62	14·21	15·06
Gold Group:						
Belgium*	2·68	2·74	3·40	3·19	3·34	3·46
France	5·95	6·34	6·31	6·00	6·19	6·45
Italy	2·42	2·41	2·79	2·78	2·69	2·47
Netherlands	2·42	2·61	2·79	2·64	2·50	2·64
Poland	0·96	1·03	1·12	0·94	0·92	1·01
Switzerland	1·21	1·27	1·36	1·15	1·35	1·50
Totals	15·64	16·40	17·77	16·70	16·99	17·53

* With Luxembourg.

From all this it appears most forcibly that the principal advantage of currency depreciation, even in a country like Great Britain, whose exports had formerly been so much handicapped by the relative over-valuation of the pound, was

not the stimulus to exports and the check to imports, but the capacity to pursue, within the national borders, liberal monetary and economic policies unshackled by care for threatened gold reserves. If those policies were successful, the effect of depreciation on the balance of trade might be moderated, even nullified, through the expansion of public buying power; if they were unsuccessful, the mere improvement of the external trade balance could not avert continued depression. On the other hand, the principal disadvantage of the situation for the countries still on gold was not the direct injury to their foreign trade but the need for still tighter internal deflation to bring their own price-systems into harmony with external prices as expressed in gold. For in no instance—neither in Great Britain, nor in the United States, nor in Japan, nor in the British Dominions, nor in Latin America—was the fall of the national currency against gold accompanied by even an approximately equal rise of prices expressed in the national currency. Hence in every instance depreciation elsewhere meant for the gold group a further measure of deflation, as well as higher barriers against international trade in order to save their own external balances of trade from magnified deficits.

In these circumstances, international currency stabilization seemed to hold out advantages to all parties. To the members of the gold bloc it offered relief from speculation in their currencies as well as a promise that other countries would not further injure them by continued depreciation. It was not perhaps the happiest harbourage conceivable for their storm-tossed economic ships, but it was at least calm water where they could repair their tattered rigging and caulk their leaking seams. To the countries with depreciated currencies, stabilization offered improvement in the invisible items of their external balance as well as an added sense of security to promote their internal recovery, while it no longer seriously threatened their gold reserves; for these had been at least nominally inflated by the fall in their currencies, and in most cases physically augmented by an influx of gold. Yet stabilization did not come. If, among the many obstacles to it, there was one more important than the rest, it was the reluctance of the off-gold countries to attach their economies to those of

a group still in the grip of deflation. The argument ran thus: prices in the gold bloc are still too high in relation to world prices; unless and until world prices rise substantially, gold prices must come down; if we tie our currencies to gold, our price-level will be forced down too, or at least prevented from rising. Since the further deflation of prices in the gold bloc seemed out of the question, the view spread in Great Britain and elsewhere that stabilization could not be achieved until the gold currencies were devalued, and that the sooner this happened the better for everybody. Meanwhile, the Publicans would not consort with the Pharisees.

Recovery in spite of instability continued through 1934 into 1935, but the distribution of recovery was now shifting. Certain of the reviving national economies lost part of their upward momentum; the pace of recovery in Great Britain, for instance, was retarded, and the same was true of the Scandinavian bloc as a whole. Again, certain primary producing countries like Brazil or Australia found themselves in fresh difficulties because their earlier improvement, preceding a general expansion of world commerce, had put a strain upon their external balances of trade.[1] In the United States, on the other hand, the tentative and unstable recovery of 1933–4 became more firmly grounded in 1935. Among the countries still on the gold standard at the old parities, while there was no relief from the strain of budgetary difficulties and currency over-valuation, and while frequent crises menaced their monetary policy, further deterioration was, on the whole, arrested by ever stricter efforts at deflation, combined with occasional injections of reflationary policy. In Germany and Italy, the two chief exponents of the policy of maintaining an artificial parity by rigid official control of exchange transactions, national economies were dominated by expenditure on armaments and war. Currency and credit were thus inflated; the most cunning devices for raising money in the service of these causes—a field in which fiscal and financial

[1] Between 1933–4 and 1934–5 Australia's imports rose by £A15,933,000, while her exports (thanks to the poor prices obtained for wool) fell by £A11,292,000. Between 1934 and 1935 Brazil's imports rose by 1,353 contos of reis, whereas her exports rose by only 644 contos.

ingenuity was at its keenest—could not disguise the fundamental necessity for drawing the necessary resources from the people, either by taxes or by inflation of the means of payment. Hence the price-levels of those countries inevitably rose, and this enhanced their difficulties in external trade, already severe enough by reason of the heavy import requirements of the armament industries. The standard of life was thus doubly lowered, both through the general rise of prices and through the cumulative obstacles in the way of buying from abroad. Among the smaller 'barricaded' countries, such as Hungary, Yugoslavia, or Bulgaria, there was a general tendency towards internal recovery, and some improvement in foreign trade.

X

THE GOLD BLOC IN DIFFICULTIES, 1934–6

(a) *The Bloc on the Defensive*

WHILE the United States was developing her expansionist policy on the basis of an inflated and still increasing gold reserve, and Great Britain was combining cheap money with a depreciated exchange as a means of letting industry find its way out of the slump, the countries of the gold bloc were suffering the pangs of intensified deflation and the injuries that arise from an over-valued currency. The 'gold bloc' came into existence as a definite, operative group, not just a convenient classification, at the time of the stabilization crisis at the World Economic Conference.[1] On the 3rd July 1933 the representatives of the European gold-standard countries subscribed to a declaration pledging themselves to the integral maintenance of that standard at existing parities; and five days later, in Paris, a similar declaration was signed by the governors of the central banks of the principal countries concerned. The recognized members of the bloc were France, Belgium, Italy, the Netherlands, Luxembourg, and Switzerland; Poland also maintained the gold standard at this time, but her active association with the others was indefinite and intermittent. In the course of 1934 several conferences were held between representatives of the six gold-bloc countries, and the opportunities of board meetings of the Bank for International Settlements were also taken for consultations between their central bank governors. At the conclusion of an official gold-bloc conference held in Geneva, a *communiqué* was issued on the 25th September 1934, declaring that

'the Powers on the gold standard are more than ever determined . . . to maintain it integrally at the present gold parity, this appearing to them as one of the essential conditions for the economic and financial restoration of the world.'

Their principal objective, they recognized, must be the enlargement of international trade, especially among themselves,

[1] See above, p. 192.

and for this purpose a special sub-committee of the six states was to be appointed. The first-fruit of this policy was a conference in Brussels a month later, at which a protocol was signed reaffirming the Geneva declaration and expressing the intention of the signatory Governments to expand by 10 per cent. the volume of trade between them, compared with the period July 1933 to June 1934. Bilateral negotiations to this end were to be begun without delay.

The plan of expanding mutual trade was faced both with particular and with general obstacles. Thus the interests of the different members of the bloc were not by any means coincident. France, the leader of the bloc, had a large and increasing active balance of trade with the remaining members, taken together. These accounted for only one-sixth of her total imports from foreign countries in the first half of 1934, whereas their share in total French exports was over one-third. Hence France's interest, from the point of view of defending her exchanges, lay in maintaining the existing trend, whereas the interest of her gold-bloc colleagues lay in reversing it. Again, there was the problem of what form these concessions might take; for most-favoured-nation treaties would prevent any open tariff discrimination. It was indicated after the Brussels Conference that France would not modify her quota policy but would allot the unfilled quotas of other countries to the members of the gold bloc.

But more powerful than such special difficulties was the overruling fact that the gold-bloc countries were swimming against the tide. The members of the sterling bloc had been able to negotiate among themselves several advantageous agreements for the promotion of mutual trade, but that was simply to further the natural process of buying in the cheapest market. On the other hand, as a London financial newspaper put it, 'preferential consideration between two countries of the gold bloc may well mean an agreement to buy goods where they are most expensive'. And even if the trade of the members of the bloc with each other could be promoted, how would this help them to maintain the gold standard? It could not strengthen their exchange position, as a group, in relation to the rest of the world. Indeed, the pressure of the balance

of commercial payments was not by any means the most powerful or most urgent danger to the gold standard in the bloc as a whole. Far more serious was the threat of a flight of money, urged by the fears that were raised by internal economic difficulties—stagnant trade, strikes, budgetary deficits, weakened credit—themselves the results of a deflationary policy too long pursued.

Deflation, of course, was not simply an erroneous doctrine adopted by a limited group of misguided individuals or countries. It was part of the apparatus used by every Government and every private economic system in meeting the world depression, at least in its earlier stages. Its continuance, after other countries turned to expansionary policies, was forced upon the gold-bloc countries by their retention of the gold standard. Nor was it merely bigotry that caused them to keep to the gold standard so long. They recognized the value of international stability which that standard could secure more readily than any available alternative. The future, if they should cast loose from their well-tried monetary anchor, was an uncharted sea. Several of them, most particularly France, had suffered already the pains that inflation and depreciation bring to a country of *rentiers*—that is to say, creditors whose assets melt away as the purchasing power of money falls. In a world of insecurities they clung to the only security they could see.

The difficulties of the gold bloc originated for the most part in earlier events, but they were aggravated after 1933 by American monetary policy. In the months of February and March 1934 alone, the United States gained, on balance, $690 millions[1] of gold, while France showed a net loss of $409 millions, Switzerland a net loss of $55 millions, and the Netherlands a net loss of $112 millions—London being only an entrepôt for these movements. Even if the dollar was not under-valued when the gold-buying policy was launched in October 1933, it was certainly heavily under-valued afterwards. Clearly there was no course open to France but still more rigorous deflation, unless she were to devalue her currency or abandon the gold standard by adopting a system

[1] Valued at $35 a fine ounce.

of foreign exchange control. In fact she chose the first course, and her wholesale price index fell by 15 per cent. between December 1933 and December 1934.

Budgetary difficulties were partly a symptom of deflation, through the fall in the yield of taxes, and partly, on the other hand, an indication that deflationary public finance must be carried still further if previous efforts were not to be nullified. The Chautemps Government of 1933 made an attempt at balancing the Budget mainly by dint of higher taxation, but the Budget for 1934 remained unvoted, and Monsieur Doumergue's Government inherited a legacy of severe fiscal and financial stringency. The Budget Bill, as passed in the early hours of the 1st March 1934, showed estimated receipts at 48,281 million francs, against an estimated expenditure of 50,162 million francs; but it authorized the Government to impose economies by decree so as to remove the remaining deficit. On the 4th April the Government published decrees showing an estimated saving of 2,760 million francs, including 500 million francs from cuts in pensions, 360 million francs from cuts in official salaries, and 750 million francs from general official reforms and reduction of the number of civil servants. Accompanying the decrees was a manifesto in the form of a letter from the Government to the President of the Republic. The authorization to impose economies by decree was described as

> 'a matter of the most imperative necessity. If Parliament had not, in conformity with the wishes of the country, given the Government this exceptional power, and if the Government had hesitated to use it, this would have meant in a short time the closing of the commerce of the state, the suspension of all payments, and failure to meet all its engagements. The only alternative was inflation and the disorders which always follow it, for inflation does not solve any problems.'

A week later the Government obtained the consent of ex-service men's organizations to pension cuts totalling 411 million francs. The decrees had as good a reception as was possible under the circumstances, but discontent at the sacrifices required by a deflationary policy undoubtedly

contributed towards the overthrow of the Doumergue Government in November 1934.

They had previously had to meet a spirited attack from Monsieur Paul Reynaud, formerly Minister of Finance under Monsieur Tardieu, who demanded devaluation as the only alternative to a regimen of deflation far more stringent than the Government were prepared to carry through. Monsieur Germain-Martin had replied that nobody could tell what would be the effect of devaluation upon prices. Were France to devalue the franc, other countries would immediately begin defending themselves by means of tariffs. Everywhere abroad monetary disorder was on the increase, and the time would come when France, thanks to her monetary policy, might be called upon to play a worthy part.

Monsieur Germain-Martin remained Minister of Finance under Monsieur Flandin, Monsieur Doumergue's successor, and his defence of the gold standard and his opposition to devaluation lost nothing in vigour. But Monsieur Flandin's emphasis was different. In his first Ministerial statement to the Chamber he declared that the régime of economic restraint had failed everywhere. 'We shall gradually return to freedom organized, controlled and defended'—a paradox that he might almost have borrowed from one of Mr. Roosevelt's 'fireside chats'. That would take a long time, added Monsieur Flandin.

> 'But the Government will day by day direct its action towards improving net costs, adapting production prices to selling prices, facilitating exchanges, assuring the marketing of agricultural and manufactured products, and developing competition.
>
> 'The reduction of the rate of interest is an essential condition of economic recovery; but it cannot be enacted by decree.'

The process of deflation, said Monsieur Flandin upon a later occasion, must be ended in France.

This series of prolegomena for an economic programme was obviously somewhat confused and self-contradictory, but it seems to have been based on the view that final prices had fallen far enough, and that production must be made profitable by the reduction of intermediate costs and by the adjustment of output to consumption. The policy becomes more

comprehensible if it is viewed in relation to the problem of the French wheat industry. For the benefit of farmers, the minimum price for wheat had been statutorily fixed at 115–30 francs a quintal[1] in 1933–4, and at 108–18 francs a quintal in 1934–5. A bounty of 80 francs a quintal was granted on wheat exported, but even this was often insufficient to make up the difference between the world price and the official minimum. This artificial rigging of the price had two main effects. It encouraged the production of wheat, although France was already faced with the problem of disposing of an accumulated surplus amounting to about 25 million quintals. And it enabled unscrupulous middlemen to make high profits; for the price of bread was fixed on the basis of the official price of wheat and flour, whereas many smaller millers and bakers obtained their supplies, in defiance of the law, at prices 20 to 40 francs below the statutory minimum. Thus the farmer sold his wheat cheap while the consumer bought his bread dear. One of the earliest actions of the Flandin Government was to bring in a Wheat Bill to remedy this situation. The legal minimum price was forthwith to be reduced to 97 francs for the next three months, after which the price would be left free to find its economic level. This in itself would presumably prevent the artificial stimulation of supplies, but farmers were also to be compelled to restrict their sowings of wheat to the average of the previous three years. The existing surplus was to be disposed of in several ways—by direct purchase for the constitution of an official 'emergency stock', by the sale abroad of denatured wheat (i.e. wheat coloured and unfitted for human consumption), and by the export of a limited quantity of millable wheat. The assent of the four principal wheat-exporting countries was obtained, under the London Wheat Agreement, to this programme, and in return France undertook to spread her exports evenly over a period of months so as to minimize the effect on world prices.

The *assainissement* of the wheat trade was followed by an attempt to secure the cartellization of industry through self-government reinforced by statutory sanctions. A Bill was published on the 10th January 1935 enabling the Government to

[1] One quintal equals $3\frac{2}{3}$ bushels.

make regional and industrial *ententes* compulsory, provided that the promoters represented two-thirds of the producers and three-quarters of the production in the area or industry concerned. The decision to give any such *entente* official authority was to be taken by the Government, but they must have the previous assent of a court of arbitration comprising representatives of the state and of finance, employers and labour. One of the objects of the Bill was to spread employment by reducing working hours, suppressing overtime, and raising the school-leaving age to 14 years. This measure, which obviously owed much to the American example, was represented by the Government as a means of transition from the existing disorganization in industry to a régime of restored competitive freedom.

The reduction of the rate of interest, declared Monsieur Flandin, was an essential condition of economic recovery. On the 9th February 1934 the discount rate of the Bank of France had been raised from $2\frac{1}{2}$ to 3 per cent., but on the following 1st June it was restored to its earlier level. On the 2nd January 1935 it was announced that Monsieur Moret had been succeeded by Monsieur Tannery as Governor of the Bank of France, and that changes had been made among the higher posts of the Treasury. The broad reason for Monsieur Moret's departure was generally known. The Government had expressed their intention of refraining from long-term borrowing in order to cheapen long-term rates of interest for private borrowers; in view of the Treasury's needs, this plan meant the issue of a large volume of Treasury bills in the course of 1935. The Government demanded active assistance from the Bank of France in the shape of rediscounting facilities for Treasury bills. Monsieur Moret refused. Under his governorship the Bank of France had strictly avoided entering the market for Government securities, and in 1933 he had expressly rejected Monsieur Bonnet's request that the Bank should rediscount Treasury bills in any but the most exceptional circumstances. The immediate outcome of Monsieur Tannery's appointment was a swift boom in *rentes*, attracting a considerable amount of capital (presumably French in origin) from London and thus driving down the value

of the pound in Paris. The boom, however, expired very quickly.

The Government's next move was to obtain from Parliament an extension of the statutory limit on Treasury bill issues from 10,000 million francs to 15,000 millions. In a preamble to the Bill for this purpose the Minister of Finance claimed that the state ought to abstain from the long-term market in order to allow bond prices to rise and to make long-term money available at lower rates to private enterprise. There was, he added, no question of inflation, and the Government remained attached to the integral maintenance of the value of the franc. But the abundance of funds in the short-term market should be made to serve the general programme for fighting the crisis. In the Chamber, Monsieur Reynaud renewed his insistence upon a choice between devaluation and deflation, declaring that in view of the over-valuation of the franc the present policy was exceedingly dangerous, since it would raise prices and make matters worse. The Bill was approved in the Chamber by the remarkable majority of 450 votes to 122.

Monsieur Flandin's determination to ease the long-term credit market by broadening the short-term market was strongly opposed by banking interests. The policy was a mild but significant attempt at reflation on the gold standard. It was not, in practice, a great success. When Monsieur Flandin resigned in May 1935, *rentes* stood at appreciably lower levels on the Paris bourse than when he initiated his campaign to raise their value. Although much of the weakness of the bond market was then due to pessimism created by the fiscal and political crisis, and to the rush of funds to the equity market in expectation of devaluation, it was certainly intensified by the lack of goodwill among the Regents of the Bank of France and other banking interests towards Monsieur Flandin's policy.

Both the Government and the Governor of the Bank had expressed emphatically their determination to keep the franc at its existing parity with gold. They could scarcely have acted otherwise without precipitating a drain of funds from France; but apart from a large-scale flight of capital there was no reason at that moment why France should be forced to abandon the gold standard or to devalue her currency, even if the

Government's policy should result in a considerable rise in internal prices. In 1934 her import surplus on commodity trade, at 5,229 million francs, was little more than half its amount in 1933. Even if it were to increase, her gold reserves were ample to meet any consequent drain. At the end of 1934 the gold in the Bank of France exceeded 82,000 million francs, against a note circulation of 83,500 million francs.

In the course of 1934, indeed, the gold and foreign exchange reserves of the Bank of France had increased by nearly 4,600 million francs (£37 millions at pre-1931 par). The experience of the smaller countries of the gold bloc was less fortunate, as far as their monetary reserves were concerned. The National Bank of Belgium lost nearly 200 million belgas of gold, the Netherlands Bank lost 80 million florins, and the Swiss National Bank 90 million Swiss francs. The total of these losses was £16 millions at the former gold parity—not in itself a large sum, but an important index of the trend of events.

Belgium was generally regarded in 1934 as financially the weakest member of the gold bloc, and the belga was constantly subject to bear speculation. The rumours of devaluation, and the consequent outflow of funds from Brussels, became particularly strong at the time of the ministerial crisis in November, and foreign aid twice came to the rescue. The Federal Reserve Banks in the United States advanced $25 millions against the gold in transit to New York, in order to relieve the acute demand for dollar exchange in Brussels. In December, Dutch and Swiss banking groups combined to lend the Belgian Government fl.100 millions on three months' bills, which might be prolonged up to one year. The new Government, under Monsieur Theunis, expressed as forcibly as had their predecessors their determination to maintain the stability of the belga and to balance the Budget. Nevertheless, in Belgium as in France, the policy of rigid adherence to the gold standard, combined with fiscal orthodoxy, was accompanied by attempts to mitigate the severities of deflation and even to move in the opposite direction. A striking attempt at the cheapening of bank credit had been made by the de Broqueville Cabinet in August. The Société Nationale de Crédit à l'Industrie was empowered to take over frozen credits from the

banks in exchange for 3 per cent. bonds, guaranteed by the state and discounted at the National Bank. The industrial debtors would be charged $4\frac{1}{2}$ per cent. by the S.N.C.I. This measure may be compared with the use of the Reconstruction Finance Corporation in the United States to liquefy and cheapen industrial credit. Nevertheless, the main trend in Belgium remained deflationary, and the consequent pressure upon wage standards caused much labour unrest.

All three of the countries mentioned—Belgium, the Netherlands, and Switzerland—managed to secure a smaller adverse balance of commodity trade in 1934 than in the previous year. Their ability to do so, by means of cuts in imports which more than offset the continued but retarded decline of the value of their exports, was a very important feature of the world trade situation at this time. Indeed, each of them actually increased the tonnage of its exports between 1933 and 1934; so likewise did France, Germany, and Poland. These facts support the view that the major economic handicap imposed on the gold-standard countries by their adherence to gold was to be found, at this stage of the depression, in the dislocation of the internal price structure rather than in the external over-valuation of their currencies. One external effect, however, did press with grievous weight upon several of them, namely, the check to tourist traffic. Switzerland's revenue from tourist business was reckoned to have fallen from 500 million francs to less than 200 million francs in the course of the world slump, and even this attenuated total was attained only by dint of public subventions to the hotel and transport industries. A further such subvention was given at the end of 1934, when it was announced that in order to encourage British visitors the Swiss Government would compensate hotel keepers for losses involved in accepting sterling cheques or notes at a fixed rate of 16 francs to the pound. The market rate at the time was 15·36 to the pound, so the concession was not startling, but the innovation was important in principle, and in fact a few months later the pound had fallen on the open market to 14·50 Swiss francs.[1]

[1] The pound was stabilized, for tourist purposes, at 74 francs in the principality of Monaco in March 1935.

One cause of instability in the Swiss franc at this period was the shadow of the coming *Kriseninitiative*. This was an economic programme promoted by the socialistic Schweizerisches Gewerkschaftsbund, largely in reaction against the extreme deflationary policy of the Minister of Economics, Dr. Schulthess (who later resigned). The avowed aim of the *Kriseninitiative*—'to assure to all Swiss citizens a sufficient livelihood'—was to be achieved by means of the planned allocation of employment, the protection of wages and prices, financial relief for agriculture and trade, additional unemployment relief, the use of the purchasing power and capital of the country to further exports and tourist traffic, control of the capital market and the export of funds, and control of cartels and trusts. The programme was to be financed by the issue of bonds, as well as from current revenue. In the form of a *Volksbegehren*, this programme received over six times as many supporting votes as were required to secure its consideration by Parliament, and although the National Council then rejected it by a majority of almost two-thirds there was some expectation of a favourable vote when it was submitted to a plebiscite on the 2nd June 1935. However, eighteen out of twenty-two cantons voted against the *Initiative*, and the total votes cast were 425,000 in favour and 566,000 against.

Meanwhile, the fall of the pound at the end of February and the beginning of March 1935 had precipitated a fresh crisis in the gold bloc. The slump in sterling appears to have been due to the withdrawal of foreign funds from London as a result of trouble in the commodity markets and rumours of disturbing political developments. Here was an extraordinary paradox; for the fall of the pound against gold currencies was an obvious threat to the latter's stability—in other words, it opened up the prospect of a fall of gold currencies against the pound. To this cause must be ascribed the 'flight into gold' that then occurred. Gold in the London bullion market commanded a premium of a shilling or more an ounce over the contemporary parity with the French franc. Rumours were current that the British Government, fearing the injury that would be done to British trade, either by a collapse of gold currencies or by higher trade barriers raised for the purpose of defending them, were

contemplating a stabilization plan. Such expectations, however, were destroyed by the Chancellor of the Exchequer on the 7th March, when he said in the House of Commons: 'I do not believe we are in a position at the present time to take the risks of putting the pound at the mercy of either the franc or the dollar.'

These events caused great uneasiness in the gold bloc, not least in Belgium. A bear attack on the belga, inspired by rumours of impending devaluation, developed in the second week in March, and as a result the pound returned approximately to the position that it had held in relation to gold currencies before the fall at the end of February. When Monsieur Theunis, the Belgian Premier, and Monsieur Hymans, the Foreign Minister, visited Paris on the 17th March, the chief purpose of their conversations with French Ministers was reputed to be to arrange for co-operation within the gold bloc with a view to safeguarding their currencies. 'The belga is saved', declared Monsieur Hymans when the talks were ended, and an official *communiqué* stated that the two Governments had reached an agreement to defend the gold-bloc currencies against speculation. The same evening, however, decrees were published in Brussels establishing a National Exchange Office to control all operations in foreign exchange (non-commercial sales of belgas being forbidden altogether), and placing all bullion dealings under the control of the National Bank. These measures were equivalent to the suspension of the international gold standard as it had been known in the days before 1931.

Still more remarkable developments were to follow. On the 19th March, only two days later, Monsieur Theunis and his Cabinet resigned, after making a statement to the effect that the unanimity of parliamentary agreement required for the defence of the belga had not been forthcoming. The position of the Government was indeed unenviable. They could not let the belga slide without confessing their weakness; they could not deliberately devalue the currency without eating their own words; and they could not impose the measures of deflation otherwise required without meeting inevitable opposition on all hands. It was not until nearly a week later that a 'National'

Government could be formed under the premiership of Monsieur van Zeeland, a Vice-Governor of the National Bank. Meanwhile the belga had been subject to heavy pressure abroad, and in the London and Paris markets a large discount appeared on the forward belga. Prevailing pessimism was reinforced by the increase of the British tariff on a series of iron and steel products, largely imported from Belgium, which took place on the 26th March. That this move should have been made by Great Britain at such a time was perhaps unfortunate in that it was liable to misinterpretation in Belgium and elsewhere; but in fact it was inspired not at all by financial motives but simply by the desire to gain bargaining strength in negotiations then taking place between representatives of the British steel industry and those of the Continental Steel Cartel. As soon as an agreement had been reached with the Cartel, indeed, it was officially indicated that the duties would be restored to their former level. The completion of Monsieur van Zeeland's Cabinet caused a rally in the belga, but it was only momentary, and on the morning of the 28th March the new Government ordered the closing of the Brussels and Antwerp bourses for three days, an action which could not be otherwise interpreted than as preparatory to devaluation.

Monsieur van Zeeland's ministerial declaration was made on the following day. The belga was to be immediately devalued by at least 25 per cent., and if circumstances required by a maximum of 30 per cent. Within these limits the belga would be kept stable against gold with the aid of an Exchange Equalization Fund, which would be credited with part of the surplus arising from revaluation of the National Bank's reserve. The Government retained their belief in the principles of the gold standard, and would take an active part in convening an international monetary conference to consider the general re-stabilization of currencies. They asked for an extension of the emergency powers granted to previous Governments, and for the acceptance of a broad programme of economic reconstruction. This included the reorganization of the banks under state supervision and with state assistance, the establishment of a special rediscount institution to thaw frozen credits, the cheapening of credit and the reduction of taxation,

the stabilization of real wages and the narrowing of the margin between wholesale and retail prices, the revision of commercial treaties on the basis of reciprocity instead of on the basis of the most-favoured-nation clause, the regulation of stock-exchange speculation, and preparations for a large Government bond conversion. After twenty hours' continuous debate in the Chamber, the Government obtained a vote of confidence by 107 votes to 54, a majority which was considered inadequate for the occasion, especially as only minorities of the Liberal and Catholic groups supported the motion. Monsieur Jaspar and Monsieur Theunis, in opposition, made much of the offer of a loan of 3,000 million belgas at $3\frac{1}{2}$ per cent. which was revealed to have been made by the French Government. The Government spokesman could retort, however, that a devaluation had been rendered imperative, not by any technical weakness of the belga or lack of liquidity at the National Bank, but by much profounder forces—in brief, by the practical inability to proceed with the measures of deflation, including wage-cuts, that were necessary if the former gold parity was to be maintained. The vote of confidence in the Senate, which was supported by 110 members against 20 noes and 19 abstentions, was held to justify the Government in remaining in office and proceeding with their economic programme.

Monsieur van Zeeland thereupon announced that the currency would be pegged at 72 per cent. of its former gold parity. Its value on foreign money markets was adjusted to the new level smoothly and immediately, but the incident had a disturbing effect upon other currencies of the gold bloc, especially the guilder and the Swiss franc, and in consequence the pound rose against gold.

Devaluation, on the face of it, threatened Belgium's commercial competitors with an under-cutting of existing prices. Belgian official policy, however, was to maintain export prices and to draw the benefit of devaluation, not from competitive expansion, but from higher prices expressed in belgas. As regards Belgium's most important class of exports, steel, price agreements on the gold or sterling basis were already in force under the Continental cartel. On the 6th April Belgium and France signed an agreement, valid for six months, whereby

the former undertook to authorize exports to France only on condition that, unless otherwise justified, prices would be no lower than they would have been but for the devaluation of the belga. A week later the Belgian Chamber of Commerce in London issued a statement declaring that the principal groups of Belgian industries had agreed with the Belgian Government 'to avoid any perturbation manifestly damaging the interests of local industries in foreign markets'. The Belgian Government had decided to exercise a strict supervision over export prices, especially those of commodities not included in the groups referred to already. If necessary, an official control would be established in the form of export licences. This system would be immediately enforced for woollen and cotton carpets, cement, bricks, and glassware.

The fall of the belga was accompanied by circumstantial rumours of impending devaluation in the Netherlands, Switzerland, Italy, and even France. It was doubtless in order to put a stop to these fears that Monsieur Flandin announced on the 2nd April 1935 that the minting of gold coins would be pressed forward with a view to their being put into circulation as soon as possible. Obviously, however, some time must elapse before a sufficient supply of gold coins could be minted to withstand the demand for them that might be expected; estimates of the necessary delay varied from two to five years. Dr. Colijn, the Dutch Prime Minister, expressed with equal vigour his determination to keep the Netherlands on the gold standard. At the beginning of April the Dutch bank rate was raised by two stages from $2\frac{1}{2}$ to $4\frac{1}{2}$ per cent., and in May the political difficulties in France precipitated a fresh flight not only from the French franc but also from the guilder and the Swiss franc.

France had a particularly anxious experience in 1935. Monsieur Flandin's attempt to combine a more liberal monetary régime with budgetary deflation and the stern defence of the franc had failed, partly because it met with opposition in banking quarters, but more because the one ingredient that could have bound that combination together—public confidence—was missing. And the underlying cause of the want of confidence was still the inability of successive Governments

to balance the Budget. No expressions of official policy, however vigorous, could stem the fears of the financial markets. Uneasiness over the budgetary situation in May 1935 gave rise to rumours of impending devaluation. The franc was heavily sold for sterling and dollars, and at the same time shares boomed on the Paris bourse in anticipation of inflation. The London 'control' was reported to be arresting the fall of the franc, an intervention that was repeated on every occasion when the gold-bloc currencies were threatened, and without which, it is fair to conclude, their parities could not have been maintained through this tempestuous period. These efforts, however, could not keep the franc above gold export point, with the result that large quantities of gold were shipped to London and New York. On the 23rd May the Bank of France raised its discount rate from $2\frac{1}{2}$ to 3 per cent., on the 25th from 3 to 4 per cent., and on the 28th from 4 to 6 per cent. By this time the flight from the franc had assumed almost the character of a panic, and the Finance Committee of the Chamber felt it their duty, they said, to express this unanimous sentiment:

> 'In presence of speculation let loose against the franc, the Committee declares itself determined to preserve the integrity of the national currency by every means.'

The surest means of preserving the integrity of the national currency was obviously to impose the taxation and economies necessary to balance the Budget, but the unanimity and determination of the Finance Committee, so formidable in respect of the end, were absent when it came to voting the means. Their brave announcement accompanied the news that they had rejected the Emergency Powers Bill put forward by the Government to deal with the financial and fiscal crisis. When the Bill was roundly defeated in the Chamber on the 30th May, Monsieur Flandin's Government resigned. After Monsieur Bouisson had formed his Government, confidence rapidly returned, and the franc rose immediately above the gold point. Monsieur Caillaux, the new Minister of Finance, declared that the revival of international exchanges was in the forefront of his preoccupations, and that this would be vastly facilitated

if the ratios of value between the great currencies, other than the franc, could be mutually stabilized in the near future.

The siege of the franc, however, was raised only for a very short spell. After less than four days in office Monsieur Bouisson's Government resigned, having been narrowly defeated in the Chamber on their Bill granting them plenary powers to deal with the financial situation. On the 7th June Monsieur Laval succeeded in forming a Government, but in a single week, while the political cauldron bubbled, the Bank of France lost £64 millions' worth of gold (reckoned at the current rates of exchange). In the three weeks ended the 7th June the drain of gold reached a total of some 9,000 million francs, equivalent to about £120 millions sterling. Then came a period of relief. Monsieur Laval's success in securing emergency powers from Parliament removed the chief political obstacle of the moment, and a quantity of gold returned to the Bank of France. By the 8th August the bank rate had been reduced by four stages from 6 to 3 per cent. The Bank of France had decided to suspend further advances against the security of gold, as a check upon speculation; this move followed an apparently independent request by the Bank of England to the London banks and bullion brokers to ban speculative forward dealings in gold—another measure of co-operation in defence of the gold-bloc currencies.

Meanwhile the Government under Monsieur Laval were pushing forward with their measures of budgetary economy and taxation. On the 17th July decrees were published effecting a total economy of nearly 11,000 million francs in the Budgets of the state, the municipalities, and the railways. The salaries of Government servants, all state pensions and Government interest payments[1] were alike cut by 10 per cent., and the coupon tax on bearer bonds was raised from 17 to 24 per cent. Payers of rent were authorized to deduct 10 per cent. from the sums due to landlords, and compulsory reductions were also effected in the prices of electricity, gas, coal, and bread.

There were signs that Monsieur Flandin's attempt at reflation was to be renewed. In August Monsieur Tannery, the

[1] Except on bonds held by foreigners.

Governor of the Bank of France, announced that the Bank would rediscount Government paper as liberally as it rediscounted commercial bills—a reversal of the traditional policy of the Regents of the Bank—and a batch of decrees presented in that month included one for the expediting of the public works programme, at a cost of a billion francs. By the end of October, when his powers to act by decree expired, Monsieur Laval had been responsible for five hundred emergency decrees, some of them extending governmental interference with private contracts to a length never before contemplated in France. But renewed parliamentary difficulties set in motion once again the forces of attack upon the franc. The movement, as before, was cumulative; for when fears of devaluation had driven down the exchange value of the franc the consequent outflow of gold sharpened those very fears. By Christmas the bank rate was up again to 6 per cent. Between the 1st November and the 13th December the Bank of France lost over 6,000 million francs in gold—approximately £80 millions; the drain was then arrested for a while, but the net loss of gold in the course of 1935 was 15,750 million francs—more than £200 millions. Although the ratio of the gold reserve to sight liabilities was still 71·5 per cent. at the beginning of 1936, every fresh loss of gold increased the likelihood of a further flight from the franc, as investors saw the reserve ratio falling and drew the inevitable conclusions for the future.

On the last day of 1935 the French bank rate was reduced from 6 to 5 per cent., and by the following 6th February it was down to 3½ per cent. The formation of the Sarraut Government on the 24th January had revived confidence in the franc, and it was the American dollar that was now showing weakness. No display of monetary ease, however, nor a temporary flight from the dollar, could alter the inner source of French currency insecurity, the difficulties of the Treasury. The lowering of the bank rate did not mean easy borrowing conditions in Paris. After a month of rumour it was announced on the 17th February that the French Government had arranged with a group of British banks a credit of £40 millions for a period not exceeding nine months, with interest at 3 per cent. Arrangements had been made between the Bank of England

and the Bank of France with the object of safeguarding the exchange from the disturbances that the transaction might otherwise involve. No further official announcement was made, but it was reliably reported that payment of the loan was to be made in six weekly instalments, and that the credit would be opened for three months in the first place, renewable for two further periods of three months. The loan might be regarded as a return of the compliment paid in August 1931, when the Bank of France lent £25 millions to London to defend the pound; as such, it was an ill omen for the later fate of the franc.

The experience of the Netherlands in 1935 was not unlike that of France. The national economy and public finances did not suddenly deteriorate, but their inner weakness made the Netherlands prone, like France, to repeated attacks on the currency, the trigger-pull being usually some political disturbance. As the aftermath of the fall of the belga, there was a 'raid' on the guilder in April 1935, compelling an increase of the Netherlands Bank rate to 4½ per cent., after a year and a half at 2½ per cent.; but the danger passed and the rate was soon down again to 3 per cent. The real crisis came in July 1935, when the Catholic party refused to support Dr. Colijn's Economy Bill. On the 24th July the bank rate was raised to 5 per cent., and on the following day to 6 per cent. Dr. Colijn vigorously expressed his intention of maintaining the existing gold parity of the guilder at all costs; it was not, however, his intentions that were doubted but his chance of remaining in office. On the 26th he resigned, but after a vain attempt by the Catholic leader, Dr. Aalberse, to form a Cabinet, he became Premier once more on the 30th. 'The attack on the guilder has failed,' Dr. Colijn declared, 'and it is the fixed purpose of the new Ministry to continue the monetary policy of the former Cabinet.' In a broadcast address he promised a serious inquiry into the practicability of measures that had been advocated for stimulating the national economy by means of public works on a large scale and by fostering industrialization. Dr. Colijn admitted that economic conditions were bad, but added that they were much better than in most countries. A few days after the formation of the new Government the bank rate was

reduced to 5 per cent. In a single week, during the crisis, the Netherlands Bank had lost over 130 million guilders in gold, equivalent to nearly £18 millions at the ruling rates of exchange. Gold soon began to return to the Bank, but in September—so suspicious were the financial markets of the political bases of the Netherlands economy—the approaching reassembly of Parliament was enough to set in motion a fresh flight from the guilder. The bank rate was restored to 6 per cent., Dr. Colijn held his ground, and the crisis passed into history, but between the 9th and the 30th September the Netherlands Bank sustained a further loss of 63 million guilders. In the course of 1935 its net loss of metallic reserves was 198 million guilders, but the year ended with the bank rate down to 3½ per cent., and on the 4th February 1936 the rate of 2½ per cent., which had ruled from the time of the World Economic Conference of 1933 until the crisis of April 1935, was restored once more.

The sudden symptoms of weakness among the gold currencies were infectious; if, for example, the guilder was attacked, the French and Swiss francs lost value also, not because they were involved in the immediate causes of the attack, but because financial operators felt that another defection from the gold bloc might mean its entire collapse. Switzerland suffered gravely from this infection of doubt, but there were special reasons also for the undermining of confidence in the Swiss franc. Certain flaws—themselves of a small order, but significant of larger difficulties—appeared in the internal banking structure. During 1935 the Swiss National Bank lost nearly 521 million francs in gold, equivalent to £34 millions at the existing exchange rate. Thus the central banks of France, Switzerland, and the Netherlands lost between them over £250 millions in gold in the course of 1935. The eventual destination of the bulk of this gold was the United States, whose net imports of gold totalled $1,739 millions. World production of gold totalled £230 millions in 1935, valued at the contemporary sterling price, to which may be added a net export of £275 millions from the three gold-standard countries mentioned above, and £33 millions released from hoards in India—an aggregate of £538 millions. The United States recorded a net import of £375 millions, and Great Britain a net import

of £75 millions, leaving £88 millions of fresh gold available for the rest of the world outside these groups. Of this, nearly £20 million was accounted for by the rise in the gold reserves of the U.S.S.R. There was evidence that a great deal of gold found its way into private hoards and speculative holdings in Europe; a sign of this process was the persistent premium on gold in the London market in relation to the exchange rate of the moment with gold-standard currencies.

Italy presented in several ways a contrast with the other countries of the gold bloc in Western Europe. For one thing, while their inward balances of trade were falling between 1933 and 1934, hers rose from 1,442 million lire to 2,408 million lire. The result was that the gold and foreign exchange reserves of the Bank of Italy fell from 7,397 million to 5,883 million lire in the course of 1934. It was not that deflation had not been vigorously applied—in many respects its enforcement was easier in the corporative than in the democratic state. In April a decree was promulgated reducing the retail prices of all foodstuffs sold in co-operative stores by 10 per cent., the rents of dwelling houses by 12 per cent., and those of shops and other buildings by 15 per cent. The salaries of all state employees earning over 500 lire a month were to be cut by 6 to 12 per cent., and the salaries of members of the Government by 20 per cent. The decree was not favourably received, and a certain amount of evasion no doubt took place, but the index of the cost of living fell sharply in May, and continued on a lower level throughout the remainder of the year.

This frontal attack upon price-levels, which it was thought necessary to reduce, contrasted with the orthodox method of deflation by credit restriction. Up to 1934 the restriction of credit was not part of Italy's deflationary practice. Large sums were spent on public works—notably the reclamation of the Pontine marshes—and although budgetary stringency compelled the Government to cut down such expenditure the purchasing-power thus put into circulation had already stimulated private industry by way of the demand for consumption goods. The budgetary deficit continued to inflate the volume of currency and credit. Another influence in the same direction was the transfer of industrial investments, largely frozen

credits, from the banks to the Institute of Industrial Reconstruction—another analogue to American measures. A direct result of the comparative ease of credit conditions in Italy, combined with the loss of gold, was the fall of the reserve ratio of the central bank almost to the prescribed minimum of 40 per cent. This in turn frightened capital away from Italy, since it seemed to threaten a forced devaluation of the lira.

Hence exceptional measures had to be taken to defend the external balance of payments. Exchange transactions were already practically concentrated in the hands of the Bank of Italy, and a number of not remarkably successful clearing arrangements had been entered into with foreign countries. In April 1934 it was announced that in future the import of copper, coffee, and wool would require licences, which would be granted only 'in relation to the balance of trade with the countries concerned'. On the 26th November the Bank of Italy's discount rate, which had been lowered to facilitate Government loan conversions, as well as for wider reasons, was raised to 4 per cent. in the hope of arresting a serious drain of gold which had just set in. For the moment, at any rate, this hope was falsified, the loss of gold being accelerated rather than checked, no doubt by reason of fears that the raising of the discount rate might be a preliminary to devaluation. On the 8th December decrees were promulgated in Rome compelling Italian residents to declare to the National Institute of Foreign Exchanges all holdings of foreign securities or other credit balances abroad. Notification must be made within ten days, but balances would not be called in until required by the Government for external payments, when compensation would be given in lire at the current rate of exchange. Meanwhile, foreign balances would be privately retained. The decrees also provided for the establishment of a committee to supervise export prices, so as to prevent the secret accumulation of balances abroad through the under-valuation of exports. Power was given to the Ministry of Finance to impose special compensatory taxes on foreign goods from countries which did not give Italian products most-favoured-nation treatment. A more rigorous system of import control by

quotas, based on the bilateral balancing of exports and imports, was introduced at the same time.

These measures were unmistakably akin to those adopted by Germany to maintain an artificial parity for the mark. No one could say that Germany was on the gold standard, and although the export of gold from Italy nominally remained free it was becoming less and less accurate to say that Italy was on the gold standard. At the beginning of March 1935, when the pound was depreciated by 42·3 per cent. against the French franc, it was depreciated by only 38·5 per cent. against the lira. In other words, the cross-rate established a discount of over 6 per cent. on the lira against other gold currencies. On a free gold standard this would obviously have entailed a great loss of gold from the Bank of Italy. Thus in practice Italy had resigned from the international standard and was rather to be ranked with Germany than with the countries of the gold bloc.

Belgium's experience after the devaluation of the belga might well have encouraged her former fellows in the gold bloc to follow her example. On balance, her National Bank was a gainer of gold during 1935, in spite of the heavy losses that it suffered before the devaluation took place. The bank rate remained at 2 per cent. from the 16th May 1935 to the end of the year. While retail prices rose only slowly, wholesale prices increased almost in proportion to the degree of devaluation, with the result that business generally became more profitable, while real purchasing-power was increased. Unemployment diminished and the prices of securities, including Government stocks, greatly improved. A big conversion operation was carried through in May, 5 and 6 per cent. bonds being exchanged for 4 per cents., with a bonus of 5 francs per 100 of the nominal value of the converted bonds. Out of 26,000 million francs involved in the operation only 90 million were registered at the National Bank as not to be converted. A small prospective Budget surplus was announced for 1936, and Monsieur van Zeeland, the Premier, declared that it had been scarcely necessary to touch the profit of 4,350 million belgas obtained by the revaluation of the National Bank's gold reserve. Extraordinary expenditure of 2,304 million belgas, however, had to be provided out of borrowing, mostly for

unemployment relief works. Belgium's import surplus did, indeed, increase in 1935 compared with 1936, but this served only as additional proof of the proposition, so amply borne out by the experience of different groups of countries all over the world in this period, that the degree of internal prosperity had little direct relation to the balance of trade, but depended rather on the internal structure of wholesale and retail prices, and on the possibility of stimulating trade through cheap money combined with public confidence.

To judge from their balances of commodity trade, on mercantilist principles, the three countries of the European gold bloc ought not to have suffered any special adversity in 1935. The increase of 240 million francs in France's import surplus must have been more than fully compensated by the improvement of shipping earnings and of the tourist traffic. The Netherlands and Switzerland both reduced their adverse balances of commodity trade, compared with 1934, the former by 65 million guilders and the latter by 129 million francs. The combined trade deficit of the group was thus reduced by over 1,050 million French francs. Yet among all the countries supplying official statistics of unemployment, these three showed the largest proportionate increases in the numbers of registered unemployed in 1935; the only other country on the list to show a substantial rise in unemployment was Poland, also a member of the gold bloc.

On the 27th April 1936 Poland left the gold bloc and placed the zloty among the artificial-parity group of currencies. By special decree free dealings in gold were abolished and all dealings in foreign currency were placed under the authority of a Government-controlled board. Transfers abroad into any currency were prohibited except under special licence; only recognized banks were to be allowed to deal in foreign currency, and no citizen was to be allowed to take more than £20 abroad except with a permit. The official rate of exchange for the zloty was left unchanged. Before the restrictions were announced the zloty was quoted in London at 26¼ to the £; three months later the nominal rate was 26½–27. On the 26th June Poland dressed herself still more exactly into the ranks of the financially barricaded countries by suspending payment

of the service of her overseas debt. The sums due were to be paid into special accounts to the credit of the bondholders, but would remain 'frozen'. The official reason given for the suspension of transfers was that the decrease of Poland's foreign trade had caused a rapid decline in the reserve of the Bank of Poland.[1] Among the loans affected were four loans issued in the United States between 1920 and 1930, of which $111 millions was outstanding, a loan of 246 million lire issued in Italy, and other international debts of the Polish Government, together with a number of municipal loans and Government-guaranteed credits (to a reported total of about $500 millions) granted by foreign banks to Polish credit institutions. Service on the sterling loan of £1,270,000 and other debts to British creditors was to be continued; for Poland's exports to the United Kingdom in 1935 totalled £7,281,000, more than one-third of her entire exports, whereas imports from the United Kingdom totalled only £3,785,000.

The spokesmen of the gold-bloc countries renewed in 1935 their pleas for all-round stabilization of currencies. In this they clearly had good cause from their own point of view; for whether or not a currency was over-valued, the main external advantage of keeping it on gold was exchange stability, and that was a game that two must play. Moreover, granted the existence of over-valuation, there seemed little hope of correcting it save in a period of exchange tranquillity during which international price-levels could gradually become adjusted to each other. Reports of impending moves towards stabilization were heard once again after Mr. Morgenthau, the United States Secretary of the Treasury, had declared in a broadcast talk on the 14th May 1935 that Washington would present no obstacle to international currency stabilization. His main argument, however, was directed to justifying the Administration in not taking the lead in this matter. If the dollar were finally stabilized on gold, he said, it would offer a temptation to others not to follow but to take advantage of the United States' disadvantage. Mr. Morgenthau added:

'So far from engaging in a competitive devaluation race with

[1] The latest return at that date showed a decline of about 140 million zloty in the gold reserve, in the course of a year, to 370 million zloty.

other nations, we hold out to them a currency of such steadiness that the normal tendency may very well be for the rest of the world to move gradually towards a practical exchange stabilization. If that can be achieved, the final step should come easily and of its own accord.'

Two days later the Chancellor of the Exchequer repudiated the implication that Great Britain ought to take the lead in stabilization.

'Just as it is no use to try to anchor a ship if the anchorage is always slipping [said Mr. Chamberlain], so, it seems to me, it would be futile to attempt to bring about stabilization in that way until we can see some prospect of stability of conditions after the stabilization has been effected.'

He added that stabilization was one of the Government's ultimate objectives.

(b) *The Italo-Ethiopian War*

Italy's economic position in the world of 1935 was not particularly enviable. Possessing a population of 42 millions, on an area of less than 120,000 square miles, one-third of which was unfit for cultivation, she could live only by exporting manufactures and specialized products in return for her needs. In this respect, of course, she was in the same case as Great Britain, Germany, Japan, and many other countries. But her deficiency in the raw materials necessary for the conduct of her industry was even more conspicuous than that of Great Britain or Germany, because her resources of coal and iron were of little account; in spite of the development of her hydro-electric resources her first requirement from abroad was fuel, the most fundamental raw material of mechanized industry. In 1934 her imports of coal and of mineral oils and by-products totalled nearly 14 per cent. of all her imports. But fast on the heels of coal in the forefront of Italy's imports was cotton, and not far behind came wool—the raw materials of her important textile industries. Hides and skins, timber, non-ferrous metals, iron and steel—all these Italy was bound to import in large quantities in order to keep her industries going and her population employed. In addition she still paid, in 1934, no less than 185 million lire for imported wheat, notwithstanding her

expensive and widely advertised efforts to render herself self-sufficient in grain.

In 1934 Italy's imports amounted to 7,667 million lire; to the tune of 5,225 million lire she paid for them by commodity exports. Her economic position in relation to the world was not shielded in any large measure by the indispensability of her products for other countries. By far her largest group of exports, amounting to nearly 30 per cent. of the total, was manufactured or semi-manufactured textiles. In the textile trade of the world there was intense international competition, and textile manufactures were one of the first objects of protection, not only in the industrial countries of Europe, but also in countries like the British Dominions that were anxious to promote their secondary industries in order to achieve 'a more balanced economy'. After textiles, foodstuffs like cheese, rice, citrus fruits and dried fruit, and wine and vermouth, formed the most important group of Italy's exports, the specified items accounting for 871 million lire in 1934. None of these could be described as staples for any importing country, and for most of them there were ample alternative sources of supply.

An adverse balance of commodity trade was a normal feature of Italy's external accounts. In 1929 the adverse balance was 6,429 million lire; in 1933 it had fallen, on a greatly reduced turnover, to 1,433 million lire; in 1934 it rose again to 2,441 million lire. The margin was made up mainly by freight and shipping receipts, tourist expenditure in Italy and the remittances of former Italian emigrants. The depression in shipping and tourist industries struck Italy hard; and at the same time she suffered severely from the cessation of migration and more particularly from the impoverishment of the United States from 1930 onwards.

While Italy's economic relations with the rest of the world were thus far from satisfactory, it must be remembered that much the same picture could be painted, by the selection of appropriate facts, of the position of any great international trading Power, not least of Great Britain, or even (though in a smaller measure) of the whole British Empire. Italy herself did little, through the economic and social policies she adopted, to meet the conditions of an intensely competitive world. Her

population was rapidly increasing on a limited area, it is true: it rose from 37,900,000 in 1921 to 42,840,000 in 1935, and was still increasing at the annual rate of ten per thousand of the population. But the authorities of the Fascist state, so far from discouraging the increase of population, did everything in their power to encourage it, though not with signal success; moreover, so far from promoting emigration within the areas and quotas left open, they were inclined to discourage it, and, by their insistence on regarding expatriate Italians as still citizens of the Fascist state, went far to justify and confirm oversea countries in their reluctance to accept Italian immigrants.

If, then, it was a major purpose of public policy to stimulate the increase of the Italian population on Italian soil, there remained no means of supporting them—Italy's internal resources being so narrowly limited by Nature—save through an expansion of foreign trade. Yet not only was the policy of the corporative state distinctly protectionist; Italy's financial economy was based on an over-valued lira coupled with an expansionist internal policy, a combination that was bound to cause a contraction of foreign trade, and to necessitate further protection in order to defend the national balance of payments. It is not too fanciful to trace the origins of the Italian outbreak in Africa—in so far as it was due to economic pressures—to Signor Mussolini's speech at Pesaro in 1926, in which he swore to defend the lira to the last drop of blood.

The blood was shed in Tigre and the Ogaden, but the lira was already past saving. The only policy capable of defending an over-valued gold currency was a course of exceedingly stiff deflation. The dictatorial, corporative state was in a far better position than democratic countries to impose a deflation of the price structure by direct action: that is to say, cutting prices all round by order. This method of price-deflation, which had been attempted in April 1934, was in itself less dangerous than the orthodox method of stringent restriction of credit, since it avoided the intermediate stage of slackened industry and enlarged unemployment. But without a restriction of credit, in particular without a budgetary contraction, it was not enough. Those conditions were absent. The Italian Government conducted a considerable programme of public works, largely

through the agency of credit institutes authorized to borrow money from the public against the security of future public revenues, or by paying the contractors in terms of deferred annuities. The cost did not, therefore, appear to any great extent in current Budgets, but formed a growing mortgage on the future. Nevertheless, the national Budget showed a persistent deficit. In the five years 1930–1 to 1934–5 the aggregate deficit was 17,671 million lire.[1] Inevitably these policies expanded the total volume of currency and credit, and, by thus supporting the price-level, enhanced Italy's difficulties in foreign trade.

The necessary consequence was pressure on the lira and a loss of gold. Various measures of exchange control were applied, and on the 21st May 1935 a decree of the previous December,[2] calling in all privately held foreign securities, was put into force. Within twenty days all such foreign assets were to be handed in to the Bank of Italy or other banks. The decree did not apply to collateral securities deposited with foreign banks if it could be shown that they were required for the purposes of trade or to guarantee a bank overdraft. At the same time a new decree was promulgated providing that all silver coins be withdrawn from circulation and replaced by coins of a cheap white metal.

As war in East Africa seemed to grow more and more certain, the tension in the exchanges became still greater. In mid-July the forward lira was quoted in London at a discount equivalent to a rate of over 30 per cent. per annum—a sounder index of the true economic value of the currency than the spot rate, which was being officially pegged at 10 to 12 per cent. discount on the gold parity. On the 2nd July the decree of 1927, fixing the Bank of Italy's minimum gold reserve at 40 per cent. of the note issue, was suspended. On the 12th August the Bank of Italy raised its bank rate from $3\frac{1}{2}$ to $4\frac{1}{2}$ per cent. In the last ten days of July 267 million lire of gold had been lost, at which rate the existing gold reserves would disappear in

[1] Figures for 1930–1 to 1933–4 taken from Professor Repaci's articles in *La Riforma Sociale* for May–June 1934 and March–April 1935; the figure for 1934–5 is the preliminary Budget estimate (quoted in Royal Institute of International Affairs: *The Economic and Financial Position of Italy*, 1935, Oxford University Press).

[2] See above, p. 382.

twenty weeks. On the 1st August a new decree went into force, establishing an official import monopoly for pit coal, carbon, coke, copper, tin, and nickel, and subsidiary products; the decree stated that the monopoly was being instituted in order to regulate 'the disposition of foreign purchases in relation to the better development of Italian exports'.

Still more drastic measures were announced a month later. All private credits abroad were to be handed over in exchange for lire, and all foreign securities and Italian securities issued abroad were to be converted into nine-year Treasury bonds bearing interest at 5 per cent. A second decree enforced a limitation of all company dividends and similar payments within Italy; for three years no industrial or commercial company would be allowed to pay a dividend of more than 6 per cent., unless more than that figure had been paid during the past three years, in which case the average of those years would become the future maximum. Any portion of profits not paid out in dividends would be invested in state funds, and would constitute a special reserve fund, which would remain the property of the company but would not be disposable for a period of three years. The third decree imposed a special tax of 10 per cent. on the interest on bearer bonds and similar securities. Finally, another decree laid down that all passenger vehicles used for public service in towns must be fitted with motors burning fuel oil or some derivative. The decrees caused an instant slump in many important industrial shares. Thus, even before the war began, and before collective economic pressure was brought to bear upon Italy, her economic position already demanded extraordinary measures, which could not be repeated and which could only be justified as means of surmounting a severe financial crisis.

If this picture shows Italy in a weak and progressively deteriorating economic position in relation to the rest of the world, it remains to be considered how the conquest of Abyssinia might seem, to an excited national imagination, to promise any measure of economic salvation. On the face of things, certainly, Abyssinia had few economic prizes to offer. At its peak of 1928–9 her foreign trade amounted to no more than £1,649,000 in imports and £1,174,000 in exports, and with

the fall in world prices for the commodities that she had to sell (chiefly coffee, hides and skins, and a certain amount of beeswax) her trade had shrunk considerably in value. Of Abyssinia's imports no less than 57 per cent. by value came from British India (including Aden), and a further 12 per cent. from Japan. The single item of salt made up as much as 40 per cent. of her imports by volume. Hence it was certainly not through obtaining control of Abyssinia's existing foreign trade that Italy could hope to secure any substantial economic relief. The economic opportunities, such as they were, lay rather in the chances of developing Abyssinia's untapped, or merely skimmed, natural resources.

It seemed extremely doubtful, however, whether Italy could find the capital necessary to develop those resources on a grand scale; if she had to borrow it, that would constitute a further strain on her balance of international payments. Italy's actual diplomatic and military policy, by antagonizing the Governments and people of the great lending countries, appeared scarcely likely to further her economic cause. The war in itself would gravely impoverish her, and deplete such capacity as she still had for the economic development of the coveted land. Its most favourable military outcome would imply continuous expenditure, for a long period of years, on 'pacification' and the defence of settlers. Thus economic motives, however vital in bringing about the state of mind and of politics in Italy in which war became an objective in itself, seem not to have been the direct impulse behind Italy's act of aggression in the autumn of 1935. The effect of economic difficulties was to produce in Italy a sense of strangulation, demanding desperate remedies as a means of psychological escape.

The imposition of sanctions inaugurated a new phase of Italy's economic life. When the decision of principle came to be taken at Geneva, only Albania, Austria, and Hungary expressed their dissent. Both Austria and Hungary had strong economic ties with Italy, and feared the disruption of their whole economies if they were to share in collective measures which would affect only a small fraction of the external trade of a country like Great Britain. The seriousness of this gap in the sanctions ring was diminished by the fact that neither

Austria nor Hungary was financially in a position to offer any big credits to Italy, or for long to sell her more than they could afford to buy from her, and she to sell to them. Germany and the United States, both non-League countries and therefore not participating in sanctions, were far more important. In 1934 Italy bought from Germany 360 million lire worth of coal, nearly one half of her total requirements, and over half her imports of machinery. From the United States she bought by far the greatest fraction of her imports of raw cotton, nearly half her imports of wheat, and one-fifth of her imports of mineral oils.

Italy's Trade with Non-Sanctionist Countries

(as percentage of total imports and exports)

	Imports		*Exports*	
	1933	*1934*	*1933*	*1934*
Germany	14·7	15·8	12·2	15·9
U.S.A.	15·0	12·5	8·7	7·4
Switzerland*	3·6	3·8	8·1	8·4
Austria	2·4	2·5	2·2	2·4
Hungary	1·0	1·3	1·1	2·5
Brazil	1·7	1·7	1·6	1·3
Japan	negligible		negligible	
Totals	38·4	37·6	33·9	37·9

* Switzerland is included because, although she concurred in the general principle of economic sanctions against Italy, she made certain reservations on account of her neutral status which limited the effectiveness of her participation in the collective measures.

While the share of these countries in Italy's trade was thus considerable (and their potential share still larger), their practical capacity to expand their sales to Italy was greatly limited, both by Italy's general difficulty in obtaining foreign exchange for payment, and by special obstacles to bilateral trade and finance.

Italy was prevented from raising a loan in the United States by the Johnson Act, forbidding such a service on behalf of a country in default on its obligations to the United States Government. Expansion of imports from Germany was handicapped by the existence of a clearing agreement, and Germany was in no position to sell goods on credit. German exporters were officially warned in October that in view of the large

accumulation of lira balances awaiting transfer they should use great caution in future dealings with Italian customers; and at the beginning of November, before the main economic sanctions went into operation, the Reich Government declared an embargo on the export of certain raw materials, in order, it was stated, to protect the economic resources of the country. The embargo covered edible oils and fats, potatoes, iron and steel, non-ferrous metals except copper, textile materials, and non-edible oils of all sorts. Coal was not included, officially on the ground that exports of coal were already subject to control. These developments went some way to reassure the League countries against the possibility of a great loss of trade to Germany, which at the same time would undermine the purpose of the economic sanctions.

The attitude of the United States remained one of the keys to the effectiveness of economic sanctions, especially those designed directly to arrest Italy's supplies of essential raw materials. In a public statement on the 15th November 1935 Mr. Cordell Hull, Secretary of State, drew attention to the considerable increase in the exports of 'essential war materials' such as 'oil, copper, trucks, tractors, scrap iron and scrap steel', and declared that 'this class of trade' was 'directly contrary to the policy of the Government' and to 'the general spirit of the recent Neutrality Act'. As the weeks passed, interest in the United States' attitude became more and more concentrated on the problem of the 'oil sanction', which was in fact the key to the whole course of collective action against Italy. Italy herself produced, and was capable of producing, only a negligible quantity of mineral oil, but she had adopted the fixed policy of encouraging the import of crude oil or residual products and their refinement in Italy. Since the beginning of 1935 the import of oil into Italy had been regulated by means of a licence system. At the same time she sought control of sources of crude oil. In the middle of August 1935 it was given to be understood that Italian interests had obtained control of Mosul Oil Fields, Limited, a company owning the whole share capital of British Oil Development, which in turn owned a concession in 'Irāq covering 45,000 square miles.[1] The A.G.I.P. (Azienda

[1] On the 11th August 1936 it was announced that the A.G.I.P. had disposed

Generale Italiana Petroli), a quasi-state concern, extended its participation in an important Rumanian oil-producing company, and through a subsidiary undertook the development of oil-fields in Albania.[1]

Nevertheless, by far the greatest fraction of Italy's oil needs was supplied by foreign-controlled sources. In 1934 she imported 1,824,000 metric tons of petroleum products of all kinds (crude oil, petrol, kerosene, residual products, and lubricating oil). Supplies from the United States (the principal oil-producer outside the League circle) amounted to barely 10 per cent. by quantity of Italy's total imports of oil and oil products. Since, however, on paper the capacity of the United States to meet Italy's requirements in these commodities was almost indefinitely expansible, an embargo without her co-operation might well have been ineffective. In a public statement on the 21st November Mr. Ickes, Secretary of the Interior and Federal Oil Controller, notified American oil producers that they 'ought to comply both in the letter and in the spirit with the United States Government's efforts to prevent furnishing war materials to either of the belligerents'.

At the meeting of the Committee of Eighteen at Geneva on the 2nd March 1936 Mr. Eden declared that His Majesty's Government were in favour of the imposition of an oil embargo by the members of the League, and were prepared to join in an early application of such a sanction if the other principal supplying and transporting states who were League members were prepared to do likewise. The oil sanction, however, was never adopted, nor were any other sanctions beyond those originally accepted as the first stage of collective economic pressure.

Meanwhile, the war and the economic and financial sanctions had had wide repercussions on world trade and finance. The first effect of the war scare was to create a small boom in

of its interests in Mosul Oil Fields to an international group associated with the 'Irāq Petroleum Company.

[1] It was announced on the 23rd March 1936 that the Italian Government would make a loan of 10 million gold francs, at 1 per cent., to the Albanian Government, over a period of five years, for the development of agriculture, the loan to be guaranteed by oil concessions. This was the largest of several loans made at that period, which, in effect, put Albania into Italy's pocket.

commodities, combined with an equally sharp slump in security values. The *Economist* index of the sterling prices of primary products rose by 8·2 per cent. between the 17th July and the 9th October 1935, and this was significantly not accompanied, as had been previous rises in the price of commodities expressed in sterling, by an equivalent fall in the gold value of the pound. The imminence of the war, however, was not alone—and perhaps not chiefly—accountable for this movement; for the underlying conditions of supply, stocks, and demand were favourable to improvements of price in most commodity markets. In an opposite sense, the general nervousness was quickly reflected in stock markets. In August 1935 a brisk market developed in insurance on war risks on shipping voyages, not only to the Mediterranean but also to other parts of the world. At the end of September, Lloyd's set up a committee to fix rates for such risks, and its first list quoted 5*s*. per cent. on cargo and 2*s*. 6*d*. per cent. on specie on all voyages to, from, or via the Mediterranean and/or the Red Sea. Since the rate on cargoes to Australasia, India, or the Far East via the Cape was fixed at only 1*s*. 6*d*. per cent., the extra premium for the Suez Canal route was sufficient to divert a good deal of cargo liner and tramp traffic. This did something to offset the gain of traffic to the Suez Canal through the movements of Italian troopers and supply ships.

The general effect of sanctions on world trade is not easily discernible. The major economic measures of collective pressure did not go into force until the 18th November, and numerous outstanding contracts and cargoes already *en route*, many of them abnormal transactions designed to forestall sanctions, protracted the former régime of trade with Italy beyond the appointed day. The effect of the disturbance to trade was naturally felt with varying severity in different areas—for instance, South Wales almost entirely lost the export trade in coal to Italy, and the south-east of France suffered more than other quarters from the partial interruption of its normally close economic relations with its neighbour. One of the countries to lose most was Yugoslavia, one-fifth of whose exports went ordinarily to Italy. Her prospective loss of exports on account of sanctions was reckoned

at 500 million to 600 million dinars a year, out of an annual total of approximately 4,000 million dinars. In recognition of Yugoslavia's peculiar difficulties, the British Government, acting under the fifth proposal of the Co-ordination Committee (mutual support), enlarged that country's permissible quota for the import of bacon, eggs, and poultry, a concession that was reckoned to be worth 100 million dinars of trade per annum.

Apart from the actual loss of exports, Yugoslavia found it increasingly difficult to obtain payment for those that she still preserved. At the end of 1935 the Italo-Yugoslav clearing balance, then in suspense, showed a debit of 175 million dinars against Italy. To quite a considerable extent Italy was using this kind of reluctant credit to finance her imports. Thus the Italo-Hungarian clearing showed such a large balance in favour of Hungary at the end of 1935 that she was able to repay the Italian *tranche*, amounting to 22 million lire, of the $20 millions rediscount credit granted by various central banks through the Bank for International Settlements in June 1931. Austrian exporters were reported to be showing considerable hesitation in dealing with Italy because of the delay in obtaining payment in schillings; and difficulties likewise stood in the way of Italian trade with the greatest of European countries outside the sanctions group, Germany. In October the German-Italian clearing showed a debit of nearly 20 million lire against Italy, whereas formerly it had been Germany who was on the wrong side of the balance. By the end of the sanctions period it was reckoned that Italy's outstanding commercial debt had mounted to 1,500 million lire.

Great Britain's experience was exceptional. Partly, no doubt, because Italian opinion was inflamed against her as the alleged promoter of the sanctions policy at Geneva, her exports to Italy fell far more sharply in the latter months of 1935 than did her imports from Italy. The Anglo-Italian clearing agreement, which went into operation on the 18th March 1935, had established a lira account for sums due to British creditors and awaiting transfer into sterling. On the 11th September the amount outstanding in the lira account was £2,008,233; on the 18th December it had fallen to

£1,608,472. Shortly before the economic sanctions went into force the British Government altered the character of the exchange clearing, making it compulsory instead of voluntary for British debtors to pay into the clearing account the sums due in sterling to Italian exporters or shipping companies; this measure indicated a certain anxiety lest the sterling assets of the account should not be sufficient to pay the commercial debts due from Italy to British exporters.

The task of estimating the economic effect of the war in Italy is rendered the more difficult by the suspension of Italian official figures after September 1935. The gold holding of the Bank of Italy, which had dropped by over 2,000 million lire between the end of 1933 and the middle of August 1935, lost a further 723 million lire in the seven weeks to the 20th September, when it stood at 4,334 million lire. The comparatively small reserve of foreign currencies also fell slightly. But this loss of reserves was accompanied by no equivalent reduction of the obligations of the Bank; on the contrary, between the 20th August and the 20th September discounts rose from 3,622 million to 4,420 million lire, advances from 1,900 million to 2,630 million lire, and notes in circulation from 13,491 million to 14,917 million lire. The ratio of gold cover to notes and sight liabilities simultaneously fell from 36 per cent. to under 30 per cent. As a natural consequence of the restrictions on foreign trade and the inflation of the currency, prices rose steeply. The index of wholesale prices (1913 = 100), which had started the year at a level of 280, had risen to 319 by August, and in October it was 352. The index of retail prices (January–June 1914 = 100) rose more slowly, but in August it stood at 433, an advance of 12 points on the figure for the previous January.

The increase in Bank of Italy advances and in the note circulation was in large measure caused by the fiscal necessities of the Government. The ordinary Budget was in no worse plight, it is true, than in previous years. The final figures for the year ended the 30th June 1935 showed a deficit of 2,030 million lire, of which 975 million lire were attributable to extraordinary expenditure in East Africa. In 1935–6, so the Minister for Finance declared to a meeting of the Cabinet on

the 20th December 1935, the Budget would close with a surplus of 20 million lire on an expenditure of 20,291 million lire. Even if his apparent optimism was justified, however, there remained the problem of paying for the Abyssinian war. The outlay of 975 million lire included in the Budget to the 30th June 1935 gave some inkling of the enormous expenditures that were bound to ensue. As early as the 23rd August 1935, additional expenditures totalling 2,500 million lire were announced 'for extraordinary requirements in the colonies and for services in connexion therewith'. The separation of war expenditure from the ordinary Budget indicated that the Government proposed to finance military operations by loans rather than from current revenue. The principal method of raising new money was the conversion of 3½ per cent. redeemable Government stock into 5 per cent. Consols. Holders were invited to take out 100 lire of the new funds, which were guaranteed against future conversions for twenty years, in exchange for 100 lire of the 3½ per cent. stock and 15 lire in cash. In September 1936 it was reported that conversions had totalled 45,000 million lire, giving the Government 6,750 million lire of new money. The offer was attractive to investors who could lay hands on the necessary cash, but it must be noted that the Government was paying in effect 10 per cent. per annum for the new money. Further funds were obtained by the Treasury through the resale of foreign securities compulsorily exchanged by private holders for 5 per cent. Government bonds, reported to be 'unquoted and unsaleable'.

Italy's anxiety to secure gold in order to replenish her currency reserves and obtain the means to purchase goods abroad was exhibited in many ways, of which the most remarkable to the popular eye—but perhaps the least important in actual substance—was the exchange of gold for steel wedding rings. On the 19th November a Royal Decree established a monopoly in the purchase of gold in all forms from abroad, and jewellers and private citizens were forbidden to buy any raw gold or second-hand gold articles whose value was determined by the gold content. On the 27th November the Bank of Italy raised its buying price for gold from Italian citizens to 15·50 lire per gramme, against a rate of 12·63 lire per gramme

based on the nominal gold parity of the lira. This was, in effect, a frank acknowledgement that the lira was off gold.

In spite of all efforts, the metallic reserves of the Bank of Italy fell with alarming rapidity. On the 20th October, the last date for which a full return was given, the gold reserves amounted to 3,936 million lire; at the annual meeting of the Bank of Italy on the 31st March 1936, the Governor stated that by the 31st December they had fallen to 3,027 million lire. The import statistics of France and Switzerland for the last three months of 1935 showed the entry of gold from Italy to the aggregate amount of approximately 1,500 million lire at mint parity. The Bank of Italy's reserves fell in that period by 1,224 million lire. The discrepancy might be partly due to variations in the date or methods of compilation of the figures, but it may be supposed that some part of the extra quarter of a billion odd was acquired by the Bank of Italy from miscellaneous sources. The Governor of the Bank, however, was careful to point out that the reserves as stated did not include the gold given to the state by the citizens of Italy, nor the foreign securities that had been requisitioned. The sums thus obtained would form, he said, a strong special reserve which would remain at the exclusive disposal of the state. In the first three months of 1936, according to the results of a questionnaire issued by the League of Nations, imports of gold from Italy or Italian colonies into the countries that replied totalled 1,092 million lire.

The gold received from Italian citizens could hardly have exceeded three-quarters of a billion lire. In addition to their gold the Italian Government could also dispose of silver called in from circulation or voluntarily relinquished by the people—worth perhaps half a billion—and of the foreign securities called in from private holders. The value of these was a matter for estimate, but well-informed opinion suggested that 2 milliards was the maximum figure for the marketable and realizable assets. If these amounts are added up, Italy's disposable international assets at the end of September 1935 may be estimated at a maximum figure of 7,870 million lire, including 370 million lire in the ordinary foreign exchange reserve of the Bank of Italy. Known losses of gold amounted to roughly

one-third of that total (2,600 million lire) during the subsequent six months. Attention has already been drawn to the accumulation of debts against Italy in her clearing accounts with Central and Eastern European countries. The supposition that if the war had been protracted over the rainy season of 1936 the pressure of sanctions would have driven Italy to a compromise seemed, therefore, to have been justified.

Italy herself claimed that through the readjustment of her import trade she had actually achieved a smaller debit balance on commodity trade since the imposition of sanctions than she had experienced a year previously. The average monthly debit for December 1935 to March 1936 was stated by the Minister of Finance, in a speech on the 19th May, to have been 213 million lire, against 246 million lire in the corresponding period of 1934–5. If these figures are accepted it follows, having regard to the unquestioned loss of gold by Italy during the war, either that her external trade was already seriously out of balance in 1934–5,[1] or that her losses in shipping and tourist traffic and other miscellaneous receipts more than made up for her success in reducing her imports to match the fall in her exports, or that she was paying out money for heavy items not included in the trade returns cited by the Minister of Finance—for instance, war materials and stores shipped direct to the war area. In fact all these possibilities would seem to have had some effect on the figures. What is certain is that the adjustment of the trade balance was achieved only by a serious depletion of industrial stocks, especially of the commodities banned for export to Italy under sanctions.

Both the embargo on certain exports and the 'import sanction' took a slow grip. The table on p. 401 shows the value of the imports from Italy into the countries that supplied the required information to the League, from November 1935 onwards. Fully one-half of the imports from Italy in February and March 1936 were imports into European countries not applying sanctions or applying them with reservations. The figures indicate that although there may have been

[1] She actually lost more gold in the first three months of 1935 than in the first three months of 1936.

substantial evasions of the undertaking to impose sanctions they did not have any drastic effect on the general trend. On the side of exports to Italy, there was a sharp contrast between most of the sanctionist countries and the non-sanctionists, especially the United States, Austria, and Hungary, who gained considerably in trade at the expense of the former group. The U.S.S.R. and Rumania, however, increased their exports to Italy through their heavy shipments of oil.

Imports from Italy

(In thousands of gold pounds)

Month	*No. of countries*	*1934–5*	*1935–6*
November	58	4,428	5,304
December	57	4,423	3,525
January	66	4,040	2,087
February	61	3,943	1,777
March	37	3,611	1,907

Meanwhile the pressure was being felt by the Italian internal economy. The automobile industry was reported to have been completely dislocated by the attenuation of oil supplies to the general public, while other industries, like textiles and building, felt severely the pinch of curtailed supplies of raw materials. On the 23rd March 1936 Signor Mussolini announced to the annual assembly of Fascist Corporations a sweeping plan of industrial nationalization. The state would encourage the small trader and the artisan, he said.

'As for the great industry which works, directly or indirectly, for the defence of the nation, and has formed its capital from public subscriptions, and the industry which has developed to such an extent as to be capitalistic or super-capitalistic, it will be formed into great units corresponding to what are called key industries. It will assume a special character in the framework of the state. Is state intervention in these units to take the form of direct or of indirect control? In some branches it may be direct operation, in others indirect operation.'

The main consideration in Italy's economic policy, declared Signor Mussolini, would be to free the country from dependence on foreign countries for raw materials. For supplies of petrol, for instance, they would increasingly rely, especially

in time of war, on the hydrogenation of lignite, on alcohol obtained from agricultural products, and on the distillation of asphaltiferous rock.

This promise—or threat—of wholesale industrial reorganization, which was generally regarded outside Italy as necessitated by the stringencies of an economic régime under sanctions, was associated with an equally drastic reorganization of the Italian banking system. On the 3rd March 1936 the Council of Ministers decided upon a policy of nationalization of the banks. Public institutions would take over from private investors the ownership of the Bank of Italy and of all the chief subsidiary banks of the country. Shareholders would be repaid at rates corresponding to actual values. Smaller banks, together with credit institutions like the Institution of Land Credit and the Institution of Public Works Credit, would be rigorously controlled by a board composed of the Ministers of Finance, Agriculture, and Corporations, with Signor Mussolini as President. The Industrial Reconstruction Institution was to be abolished. Thenceforward all new public issues of capital made through banks or credit institutions would be subject to direct veto or approval by the Bank of Italy. Thus, apart from their political implications, the League sanctions left permanent traces, not only upon Italy's external balance of payments, but also upon her internal economic life.

XI

THE END OF THE GOLD BLOC, 1936

(a) *The Popular Front in France*

THE fall of the franc from the 'Poincaré' gold standard had been so long expected that by 1936 many people who had once been impressed by its inevitability had ceased to give credence to the economic prophets. But the cry of 'Wolf, Wolf!' is unnerving even if it has been heard often before, and anxious capitalists thought that they heard the baying of the pack itself when the elections of May and June 1936 brought a Government of the Left into power in France with a policy of social and economic reform that was bound to raise costs and almost certain to penalize capital. Between the 29th May and the 5th June the Bank of France lost 1,500 million francs of gold—nearly £20 millions at the rate of exchange then ruling. The nervousness was increased, and the outflow of capital accelerated, by the outbreak of strikes and by other forms of labour agitation.

But behind the momentary scares and temptations lay even more powerful forces driving the franc towards devaluation. It was unmistakably over-valued in relation to other currencies, outside the barricaded zone of Central and Eastern Europe. Assuming that before the depreciation of September 1931 the pound was over-valued by 10 per cent. against both the franc and the dollar, there had been reached by September 1935 something approaching a fresh equilibrium, on the basis of relative levels of wholesale prices.[1] The apparent 2·8 per cent. over-valuation of the pound in relation to the dollar, and its apparent 2·7 per cent. under-valuation in relation to the franc, were small enough to be accounted for by the unavoidable margin of statistical error, and certainly not too large to be wiped out by a comparatively small further rise in American prices. But a different story was told by a comparison of cost-of-living index numbers. Although, on this basis, the degree in which the franc was over-valued had fallen

[1] See the *Economist*, 30th May 1936.

substantially, it was still (in September 1935) as high as 34 per cent. against the pound and 54 per cent. against the dollar. In other words, the price of francs was half as much again in terms of dollars, and one-third as much again in terms of sterling, as it ought to have been if a given sum of money was to go as far in one country as it went in either of the others.

That divergence between the movements of wholesale and retail prices in France meant for industry a high cost-structure and poor returns; it meant reduced taxable capacity and intensified resistance by the workers to the wage-cuts necessary in order to re-establish a profit margin for their employers. It was the bitter end of deflation. Cost-cutting could go no farther, and only an inflation of wholesale prices could afford any relief. This inflation came about in the latter part of 1935 mainly through borrowing by the Government to meet Treasury deficits. The French wholesale price-level rose by close on 10 per cent. in six months, between September 1935 and March 1936. The result was a renewed widening of the over-valuation of the franc in relation to competing currencies. Even on the basis of wholesale prices, the franc was 9 per cent. over-valued against the pound and 20 per cent. over-valued against the dollar in April 1936, a month before the elections swept the Popular Front into power. The tide of deflation had risen to the flood, and was now falling rapidly, yet it had never reached the high-water mark at which equilibrium would have been restored with the pound and the dollar.

The internal economic situation to which Monsieur Blum fell heir may almost be likened to that which faced Mr. Franklin Roosevelt when he became President in 1933. In place of the closed banks of America there were the thousands of factories, hotels, and large shops of France occupied by 'sit-down' strikers, whose technique was soon to be borrowed by their 'class comrades' across the Atlantic. The strike wave was stemmed (though it took some weeks to recede) only by the signature of a pact, in the early hours of the 8th June, between representatives of the employers and of the Confédération Générale du Travail (the 'Matignon agreement'), whereby the employers agreed to raise wages by fractions between 7 and 15 per cent., to acknowledge the right of the

men to organize themselves in trade unions for collective bargaining, and to permit them to elect shop stewards or union delegates. 'The French trade unions have won the greatest victory in their history', declared Monsieur Jouhaux, the Secretary-General of the C.G.T.

The pact with the unions, however, was but the industrial aftermath of political decisions. On the 6th June Monsieur Blum had presented to the Chamber his Ministerial Declaration, in which he had announced the immediate presentation of an important group of Bills. They would concern a political amnesty; the enforcement of a forty-hour working week; the application of collective labour contracts; holidays with pay; a scheme of public works; the nationalization of the armaments industry; the establishment of a wheat office that would set the pace for the revalorization of other agricultural products; the raising of the school-leaving age; a reform of the statute of the Bank of France, guaranteeing the preponderance of national interests in its management; and a first revision of the economy decrees in favour of the most severely penalized classes of civil servants and ex-service men. As soon as those measures had been voted the Government would present to Parliament a second series of Bills concerned with unemployment, insurance against agricultural catastrophes, the revision of agricultural debts, and a scheme of old-age pensions. Shortly afterwards they would present a broad scheme of revision of the tax system, relieving industry and commerce and seeking new resources from inherited fortunes, from the prevention of evasion, and especially from the revival of general economic activity.

It might have been thought that the devaluation of the franc would have been a natural and deliberate concomitant of this programme, involving as it did increased national expenditure as well as higher costs of living and greater charges upon industry. But that was not Monsieur Blum's policy. The Government, he declared, would not devalue the franc, but would try, by a policy of creating large credits, to obtain the same results in France as devaluation had secured in other countries. This was, in effect, a repetition of Monsieur Laval's defeated policy of reflation on gold. Monsieur Blum's

declaration was criticized not only by Monsieur Paul Reynaud, the long-standing champion of devaluation, who warned the Government that by the time when they were eventually forced to devalue they would find it a far more difficult task than at that moment, but also by such authorities as Monsieur Charles Rist, who wrote:

> 'The maintenance of the franc at any cost means that the entire French economy is bound more and more by controls and prohibitions at the time when it has need of finding initiative again, and of remaking contact with the group of great Anglo-Saxon economies, which are the only prosperous ones to-day.'

Monsieur Caillaux likewise forsook his former advocacy of deflation, declaring that the inevitable rise in prices must lead to a system of *autarkeia* under which France could not live; in order to correct that condition it was necessary to

> 'precipitate monetary alignment by agreement first with the gold bloc countries and subsequently with the great nations with wandering currencies, which alignment, accompanied by broad commercial accords, will involve monetary and economic peace, an escort to political peace.'

It was puerile, he added, to think of clinging to policies which events and human errors had killed. Even Monsieur Germain-Martin, who had been responsible for the defence of the franc in more than one Cabinet since 1931, was found supporting a plan that meant, in effect, external devaluation, while the legal gold equivalent of the franc would be unchanged.

In face of these criticisms as well as of the ineluctable economic facts driving the franc towards devaluation, Monsieur Blum must have had powerful reasons for opposing it. It is possible to discern at least three. First, the Communists, who were a necessary element in the Popular Front majority, were strongly hostile to devaluation. They saw in it a means of robbing the French worker, through a rise in the cost of living, of the social and economic gains secured for him by industrial and political action; and as a party they had no interest in preserving the general health of a capitalist economy by a restoration of profits. Secondly, the Popular Front had just won an election on an anti-devaluation platform. Thirdly,

Monsieur Blum and his colleagues were statesmen enough to realize that devaluation by France alone without agreement either with her colleagues in the gold bloc or with Great Britain and the United States would be a perilous and perhaps a fruitless operation. Hence they renewed their expressions of determination to maintain the gold value of the franc, and their expostulations were enough to check for the time being the outflow of capital and to cause a rally in the franc on the exchange markets. Between the 19th June and the 7th August the Bank of France gained 1,036 million francs' worth of gold—about £14 millions. In the previous three months the net loss of gold had been 11,748 million francs—£157 millions.

Meanwhile, the Popular Front Government had been putting into law their social and economic programme. The labour laws enforcing the system of collective contracts, annual holidays with pay, and the forty-hour week were followed by the nationalization of industries making munitions of war, the authorization of a large programme of public works, the enforcement of a system of controlling prices, a reorganization of the coal trade, and the creation of a national monopoly in the distribution of wheat. The last-named measure may be compared with Monsieur Flandin's attempt in 1934 to bring health to the wheat trade by removing some of the artificial impediments and allowing the price to find its natural level. Monsieur Blum's Bill sought, by contrast, to maintain a fixed price and to guarantee a market to the farmer. The price would be fixed by a National Wheat Office as soon as possible after each harvest, and every farmer would have the right to sell 185 bushels outright to the co-operatives and to obtain an advance of two-thirds of the price on the rest of his crop. The Office would have a monopoly of imports and exports of wheat, and if there proved to be a surplus of wheat for export, at prices below the French level, it would be entitled to recoup itself by deducting up to 20 per cent. from the fixed price payable to the larger farmers.

At the end of July the Government tabled a series of Bills for the extension of credit to industry, in order to overcome the strain of higher costs due to the raising of wages, the reduction of hours, and the introduction of paid holidays. For

internal trade, the Bank of France would furnish funds at 3 per cent. plus $\frac{1}{5}$ per cent. for costs, and the credits would be for ninety days, renewable twice. Their amount was not to exceed the additional charges upon industry due to the labour legislation, or 12 per cent. of the wages actually paid in the previous year. The state would guarantee these credits up to a limit of 3,500 million francs. For export industries the credits would be offered at $\frac{1}{2}$ per cent. plus costs. If, at the end of their nine months' term, the advances were still required, they would be prolonged and consolidated through a special institution. Credit would also be forthcoming for the liquefaction of frozen credits abroad. French exporters had about £300 millions locked up in Italy, and these credits might now be rediscounted at about 3 per cent., in place of the 7 per cent. to 9 per cent. previously asked. The export credits guarantee system, hitherto applicable only to contracts with foreign public bodies, would be extended to contracts with private importers, and the limit of the state's engagements would be raised from 1,000 million francs to 2,000 million francs. The Government also proposed to increase the subsidy to merchant shipping by 110 million francs for the remainder of the year; the deficit of the state-controlled Messageries Maritimes would also be 50 million francs greater than had been anticipated.

The cheapening and expansion of credit, directly or indirectly dependent on the facilities of the Bank of France, implied a radical change of policy and outlook on the part of that institution. The reform of the Bank of France had been one of the issues raised most prominently by the parties of the Left in the election. Although the Governor and two Deputy Governors of the Bank were appointed by the President of the Republic on the advice of the Government, the Bank remained, like the Bank of England, a private concern, and its general administration was in the hands of a Council of Regents elected by the 200 largest shareholders. As there were about 40,000 shareholders, two-thirds of whom held only one or two of the 1,000 franc shares each, the system represented a close and largely hereditary oligarchy, and there was a popular legend of the 'two hundred families' who were supposed to hold French finance in thrall. Under the reforms of

the Popular Front Government, the Council of Regents was entirely reorganized. Of its twenty members (apart from the Governor and Deputy Governor), the Ministers of Finance, National Economy, and Colonies were to appoint one each, and six were to be members by virtue of their offices at the head of Government financial departments; six were to be nominated by the Minister of Finance from a list submitted by various national associations, including trade unions; one was to be nominated by the National Association of Savings Banks, one by the National Economic Council, and one by the staff of the Bank itself; finally, two others, engaged in industry and commerce but having no connexion with any banking house, were to be elected by the general body of shareholders. This scheme clearly converted the Bank into a public, if not entirely a governmental, concern. But a show was also made of establishing a more democratic system among the shareholders themselves. Every shareholder of French nationality was to be entitled to one vote in the General Assembly, irrespective of the size of his shareholding. The Assembly's powers, however, were to consist in little more than electing two members of the Council and the three *censeurs* (auditors), who were to sit with the Council in a consultative capacity only.

The new Minister for Finance, Monsieur Vincent Auriol, denied that there was any question of nationalizing the private banks, which would be subject only to the same kind of general supervision as industrial firms. The Bank of France itself, however, was also a great commercial bank, maintaining about 650 branches and subsidiary offices. It thus had a direct as well as an indirect control over the private and commercial credit structure of the country. This lent additional importance to its new cheap-money policy, initiated by Monsieur Labeyrie, who replaced Monsieur Tannery as Governor immediately after Monsieur Blum's entry into office. When the Popular Front Government came into power the bank rate was 6 per cent. By the 9th July it had been restored by three stages to 3 per cent., and the Bank's loan rate, which had been 8 per cent. a month previously, had been reduced to 4 per cent.

The relaxation of interest rates, the return of refugee money, and the influx of gold were associated with the efforts of Monsieur Auriol to refill the drained coffers of the Treasury. In his statement of the 19th June he estimated the Budget deficits in 1934, 1935, and the current year, 1936, at 8,800 million francs, 10,000 million francs, and 7,000 million francs respectively. In the past four years—the life of the previous parliament—he said, the redeemable debt of the state had increased by 75,000 million francs, against a fall of 44,000 million francs in the perpetual debt. For the next six months an almost empty Treasury had to meet an estimated outflow of over 10,000 million francs: 2,000 million francs for the Budget deficit, 5,000 million francs for national defence to be met out of capital, and 3,000 million francs needed to repay the loan made in February 1935 by the British banks. Yet of the 22,780 million francs of Treasury bills that had been sanctioned, 21,940 million francs had already been issued, including 14,000 million francs rediscounted by the Bank of France. The needs of the Treasury confronted a public that had preferred hoarding to lending. In the previous eighteen months, said Monsieur Auriol, 26,000 million francs had been exported abroad in the form of gold, foreign currency, or securities. Private hoards of gold in France had risen from 4,500 million francs to 6,000 million francs since the beginning of 1933. A total of 30,000 million francs in Bank of France notes was also hoarded.

Repudiating the idea of a capital levy, Monsieur Auriol announced the Government's plans for dealing with the situation. They would in a few days issue short-term bonds in small dimensions to be marketed all over the country, not only by the banks but also by post offices and other Government institutions. In the meantime, in order to meet current expenses, the Government would frankly and directly ask the Bank of France to open a credit for them, which would not be used if the short-term bonds were taken up as they hoped. The credit would have a maximum limit of 10,000 million francs. The 14,000 million francs in Treasury bills rediscounted by the Bank would be converted into temporary advances bearing no interest. At the same time the legal

maximum issue of Treasury bills would be reduced to 20,000 million francs, but this would still admit a total of 12,000 million francs as yet unissued.

The financial plan of the Popular Front's economic strategy for the short run was thus reflation on the gold standard combined with the restoration of confidence. If the latter was lacking, the former was impossible. The appeal to the nation for subscriptions to the special short-term bonds, which were promptly dubbed 'Baby Bonds', was regarded on all hands as the test of financial confidence. The issue was made on the 10th July, in the form of Treasury bonds with a currency of one year or six months. The yearling bonds bore interest at 4 per cent., and the six-months bonds at 3½ per cent. Even with so high a rate of return the bonds—which would have been very attractive to British and American professional investors but for the risk of loss on exchange—met with no great success. By the 4th August public subscriptions had exceeded 2,300 million francs, and there had been a slow return of gold to the Bank of France; but this figure was considered definitely disappointing by the market, and the bank return of the 7th August was the last to show an increase of the gold reserve. Only 4,000 million francs had been subscribed by the 23rd September, when the issue was suspended. The Spanish war heightened the nervousness of investors, with the result that capital once more began to seep out of France.

The authorities of the British Exchange Equalization Account, who had had to buy francs and convert them into gold at the Bank of France in order to prevent a collapse of the spot rate for francs, chose this period to bring to London large sums in gold which they held under earmark. In the first fortnight in August gold flowed into England from France at the rate of over £13 millions a week. The Exchange Equalization Account had sold to the Bank of England since the beginning of the year gold to the nominal value of some £45 millions. This sale of gold to the Bank was dictated both by the needs of the Account, which had seen its supply of sterling steadily depleted, and by those of the Bank of England, which had seen its reserve depleted as a result of a growing demand for

currency. The call for currency was itself due partly to the hoarding of British notes by Continental holders. Contemporary expert estimates placed the total of hoarded sterling at about £30 millions.

The French Government made unavailing attempts to check administratively the outflow of capital. An Act of the 13th August 1936 obliged banks and financial concerns to disclose particulars of all securities, not acquired in trading on the bourse, exported by them or through them since the beginning of 1934. This requisition was additional to the law compelling citizens to declare what capital they held abroad at the 31st December 1935 (property acquired in the course of 1936 need not be disclosed till the end of the year). The period of grace for such declarations, which was to have expired on the 1st September, was extended by the Government. Restrictions were placed on the purchase of foreign bank-notes; the sale of gold coin was virtually prohibited; and travellers from France were obliged to declare any gold or precious metals that they were taking from the country. Heavy punishment was provided for any one who knowingly spread rumours calculated directly or indirectly to shake the confidence of the public in the soundness of the currency, or who incited others to withdraw deposits or sell Government securities. It was explained in the debates on this measure that a genuine advocacy of devaluation was not proscribed—a necessary proviso, since even the Governor of the Bank of France was talking cautiously of 'currency realignment'. On a visit to the President of the Netherlands Bank at the beginning of August, he declared that an international currency understanding was indispensable for a return to more normal economic conditions, and that such an understanding must be accompanied by a new alignment of currencies.

A series of political and economic troubles in France increased the pressure on the franc. Early in September many observers feared the break-up of the Popular Front Government over Monsieur Blum's policy of non-intervention in Spain. No sooner were these fears laid aside—after the franc had fallen to the lowest rate against the pound for over two years—than a fresh wave of strikes swept industrial France.

A great strike in the Lille textile industry was settled on the 17th September, after intervention by Monsieur Blum and his Minister of the Interior, on a basis of a 6 per cent. rise in wages. While settlements such as these relieved fears of immediate catastrophe, the rise in the level of wages was regarded as certain in the long run to undermine the international value of the franc. Reassuring statements by Ministers had little lasting effect.

A financial market already convinced that devaluation was inevitable paid excited attention to the report of the League of Nations Financial Committee to the Council, published on the 22nd September, in which the opinion was expressed that the disparity between internal and external currency values was the greatest obstacle in the way of world-wide recovery. In a feverish market, the British Exchange Equalization Account, operating in London, held the spot rate for francs at about 77 to the pound sterling, at the cost of buying enormous quantities of foreign currency. The American exchange fund, operating in Paris, was also forced into heavy purchases of francs, though the rate at which the spot exchange was pegged allowed large and profitable arbitrage transactions in gold to take place between Paris and New York. Net imports of gold into the United States from France, which had been small in July and August, rose to $136 millions in September and $95 millions in October, practically all the latter amount having been contracted for before the 20th September.

The forward exchange rates provided a truer index of the market's estimate of the probable future of the franc. On the 24th September the discount on three-months francs in London touched 8 francs. On that day the French bank rate was raised from 3 to 5 per cent. A rise in the bank rate was the classical weapon of defence against an outflow of gold, but, as on other occasions in the history of acute currency instability, the practical effect was the reverse. The raising of the rate was regarded as a sign, not of strength, but of weakness, all the more because it represented a complete reversal of the French Government's previous policy of cheap credit. On the 25th September, in a market full of rumours, the discount on three-months forward francs rose to a level equivalent to

approximately an even bet on devaluation by 25 per cent. within the three months.

(b) *The Three-Power Currency Declaration*

Late on the 25th September, the French, British, and United States Governments issued statements in similar terms, *mutatis mutandis*, announcing the devaluation of the franc. The British *communiqué* ran:

'1. His Majesty's Government, after consultation with the United States Government and the French Government, join with them in affirming a common desire to foster those conditions which will safeguard peace and will best contribute to the restoration of order in international economic relations, and to pursue a policy which will tend to promote prosperity in the World and to improve the standard of living.

'2. His Majesty's Government must, of course, in its policy towards international monetary relations, take into full account the requirements of internal prosperity of the countries of the Empire, as corresponding considerations will be taken into account by the Governments of France and of the United States of America.

'They welcome this opportunity to reaffirm their purpose to continue the policy which they have pursued in the course of recent years, one constant object of which is to maintain the greatest possible equilibrium in the system of international exchanges, and to avoid to the utmost extent the creation of any disturbance of that system by British monetary action.

'His Majesty's Government share with the Governments of France and the United States the conviction that the continuation of this twofold policy will serve the general purpose which all Governments should pursue.

'3. The French Government inform His Majesty's Government that, judging that the desired stability of the principal currencies cannot be ensured on a solid basis except after the re-establishment of a lasting equilibrium between the various economic systems, they have decided, with this object, to propose to their Parliament the readjustment of their currency. His Majesty's Government have, as also the United States Government, welcomed this decision, in the hope that it will establish more solid foundations for the stability of international economic relations.

'His Majesty's Government, as also the Governments of France and the United States of America, declare their intention to

continue to use the appropriate available resources so as to avoid so far as possible any disturbance of the basis of international exchanges resulting from the proposed readjustment. They will arrange for such consultation for this purpose as may prove necessary with the other two Governments and the authorized agencies.

'4. His Majesty's Government are moreover convinced, as are also the Governments of France and the United States of America, that the success of the policy set forth above is linked with the development of international trade. In particular, they attach the greatest importance to action being taken without delay to relax progressively the present system of quotas and exchange controls with a view to their abolition.

'5. His Majesty's Government, in common with the Governments of France and the United States of America, desire and invite the co-operation of the other nations to realize the policy laid down in the present declaration. They trust that no country will attempt to obtain an unreasonable competitive exchange advantage and thereby hamper the effort to restore more stable economic relations which it is the aim of the three Governments to promote.'

In Paris it was announced simultaneously that the franc would be maintained at a level within the limits of 49 and 43 milligrams of gold, nine-tenths fine. Since the former gold content of the franc had been 65·5 milligrams, this represented a depreciation of 25·2 to 34·4 per cent. An exchange equalization fund of 10,000 million francs would be established, in charge of the Bank of France but under control of the Treasury. All stock exchanges and foreign exchange markets in France were closed, while Parliament was called in special session to discuss the Bill to legalize devaluation.

Besides fixing the legal limits of devaluation and setting up the new fund, this measure (as amended and passed on the 1st October) provided for the revaluation of the gold reserve of the Bank of France on the basis of the higher limit of the franc's new gold-content. The increment, which would amount to about 17,000 million francs, would, with the surplus accruing from the revaluation of foreign exchange holdings, be assigned to the Government; 10,000 million francs would form the exchange stabilization fund, and the remainder would go to reduce the interest-free advances of the Bank of

France. The law also obliged all persons of French domicile to declare their gold hoardings at home or abroad as on the 26th September, and provided severe penalties for default. All transactions in foreign exchange in the week preceding devaluation must also be disclosed. An extraordinary tax of 50 per cent. was imposed on net profits arising from forward transactions in French security markets during that week, except transactions in French Government securities and those arising out of ordinary commercial business. Power was granted to the Government to combat by executive action any increase of prices not justified by the higher cost of imports, and to settle labour disputes arising from any increased cost of living between the date of devaluation and the 31st December. On the 2nd October, after the devaluation measure had passed into law, the French bourses and exchange markets reopened, and the Bank of France reduced its discount rate from 5 to 3 per cent.

Up to the moment of the issue of the three-Power monetary declaration, its secret had been perfectly kept, although its terms must obviously have been carefully deliberated for some time beforehand. Monsieur Auriol indeed revealed that negotiations for an agreement had been carried on ever since the Popular Front Government came into office. The French Government would never have devalued by unilateral action, said Monsieur Blum in a press interview; they were prepared to devalue, however, as the first step to a new era in economic relations. It was from its character as a first step that the declaration drew its chief economic importance; for its actual terms did not go far. The immediate practical purpose was a temporary one: to avoid as far as possible the disturbance of the international exchanges resulting from the readjustment of the franc. 'Sterling is still free', declared Mr. Neville Chamberlain on the 6th October. 'It is not linked to gold or to any other currency.' On the same occasion, however, the Chancellor of the Exchequer expressed his disbelief in the permanence of a system of managed currencies.

'I do not see any reason to alter the view which I have expressed before—that in the end we shall probably come back to an international monetary standard on the only basis which appears to

give general confidence. Of course, it will be necessary before we do that to provide security against those violent fluctuations in the value of gold as expressed in terms of commodities which have occasioned so much disturbance in recent years.'

There can be little doubt that the French Government made an effort to secure a restoration of the international gold standard as part of the currency alignment, and that their inability to persuade the British and United States Governments to accept this postponed the devaluation of the franc until its position had deteriorated violently.

The pressure of time under which the final decision was reached precluded previous agreement between France and the other countries of the gold bloc, though it was also suggested that the necessary secrecy would have been endangered had more countries been brought into the discussions. In any case, the collaboration of Switzerland and the Netherlands in devaluation might not have been easily secured. The Governor of the Netherlands Bank was in Paris on the 25th September, and presumably was informed at least of the possibility of devaluation and of the three-Power agreement. Yet he and the Netherlands Government announced, after the French decision had been published, that the Netherlands would maintain its monetary policy unchanged. The Swiss Federal Council was also apparently of opinion that Switzerland had no such special reasons as France for devaluing her currency; for after an emergency meeting of the Council on the morning of the 26th September it was publicly announced that the Swiss franc would not be devalued.

At 2 o'clock on the same afternoon, however, the announcement was reversed, and on the following day the Federal Council decided to instruct the National Bank to reduce the gold content of the Swiss franc to a level between 190 and 215 milligrams. The previous gold content having been 293 milligrams, those limits were equivalent to devaluation by a percentage between 26·6 per cent. and 35·2 per cent. Increases of retail or wholesale prices, hotel tariffs, prices for gas or electricity, or rents, would be prohibited except with the approval of the Minister of Economics. The Swiss decision caused the Netherlands Government also to change their

mind. After an emergency Cabinet meeting on the evening of the 26th September, the Governor of the Netherlands Bank issued the following statement:

'After the monetary measures taken in France and Switzerland, Holland is the only country which has kept its currency on its previous gold basis, and therefore it will be exposed to heavy pressure on foreign exchange rates and gold stocks, so that the necessity of pursuing the present monetary policy cannot be considered as still existing.

'To prevent being forced to abandon the gold standard, the Netherlands Government . . . has decided, in full accord with the Netherlands Bank, to lay an embargo on gold exports from the 27th September, unless such exports are covered by the authentic certificate of the Netherlands Bank.'

On the 26th September alone, which was a Saturday, the Netherlands Bank had sustained losses of gold amounting to nearly £3 million at the pre-devaluation rate of exchange.

Thus, in some confusion, the gold bloc came to an end. Its origins may be traced back to the Latin Monetary Convention of 1865 between France, Belgium, Switzerland, and Italy, to which Greece also acceded later. The Latin Monetary Union was on the 'limping' bimetallic standard, which gradually became assimilated to the gold standard in practice. The Union formally came to an end in 1926, but from its inception until September 1936 Switzerland had not altered the gold content of her currency. The Netherlands was on the silver standard until 1873, and for two years thereafter had no metallic standard, but like Switzerland she had escaped the necessity of reducing the gold content of her currency for more than two generations.

Every attack on the French franc had had repercussions upon the Swiss franc and the guilder, not only because devaluation in France was expected to draw the other currencies with it, but also because the most powerful and permanent reasons for devaluation were common to all members of the gold bloc. Over-valuation of the currency was a feature of all three national economies. Yet, in spite of periods of loss, the gold reserve of the Netherlands Bank actually increased by some £20 millions net in the twelve months preceding

devaluation, and that of the Swiss National Bank by over £12 millions. The whole of the latter sum was accounted for by imports of gold from Italy. This strengthening of their gold reserves made it all the easier for the two smaller countries of the gold bloc to keep interest rates low, as part of their official policy of recovery on the gold standard. Neither central bank made any immediate alteration in interest rates as a result of devaluation, but on the 20th October the discount rate in the Netherlands was reduced from 3 to 2½ per cent., and Switzerland followed with a reduction from 2 to 1½ per cent. five weeks later. The Netherlands bank rate was lowered to 2 per cent. on the 2nd December.

The character of the devaluation was different in the two countries. Neither of them restored a fixed rate of convertibility between currency and gold, and both set up exchange defence funds. But, whereas for the time being the gold system was suspended altogether in the Netherlands, it was announced in Switzerland on the 29th September that the free movement of gold would be maintained.

> 'Switzerland intends to follow the currencies of the big Powers at a distance of ten per cent. The Swiss currency will be based on gold. Alignment on American, British, and French currencies will only be effected in so far as these currencies are stabilized on a gold basis.'

The Swiss Government did not announce their decision to adhere to the three-Power currency agreement until the 4th November, and the Netherlands Government not until the 24th November 1936.

On the other hand, Belgium adhered to the three-Power agreement without hesitation immediately after it had been published. Speaking on the 4th October, the Premier, Monsieur van Zeeland, repudiated suggestions that the French devaluation would adversely affect the position of Belgium. On the contrary, France, by dint of her internal recovery, would be able to buy more goods, and her new monetary policy would undoubtedly facilitate world stabilization. An incidental advantage to Belgium of the cheaper franc and guilder was the saving on interest and redemption charges on

the many public and private loans raised by her in the money markets of France, Switzerland, and the Netherlands; the Minister of Finance stated on the 30th September that the national debt charge alone would be thereby reduced by 100 million francs a year.

The economic improvement in Belgium after devaluation had continued in 1936. Unemployment declined and the 'scissors' of wholesale and retail prices became more favourably adjusted. In eighteen months retail prices rose by 10 per cent., while wholesale prices rose by 25·4 per cent. Handicaps to the country's economic advance appeared, however, in political and industrial disturbances. The weakening of the Government's majority and the rise of the Rexists and Communists at the elections of May 1936 gave a certain shock to confidence. Partly through contagion from the successful demonstrations by Labour in France, a rash of strikes, particularly in the coal industry, broke out in the middle of June. They were settled on terms conceding most of the workers' demands; wages were to be raised, there were to be holidays with pay, and trade unions were to be recognized. Only regarding the introduction of a forty-hour week was a certain delay conceded. On the 24th June the Prime Minister outlined to the Chamber the economic and social reforms that had been adopted by the Government. They included minimum wages, holidays with pay, the forty-hour week in unhealthy trades, an effort towards reduced taxation in the interests of the middle classes, a control of the private manufacture of arms, a tightening up of company law and the regulation of financial business, re-examination of the statutes of the Bank of Belgium, the conversion of external debt, the establishment of a credit institute for agriculture, and far-reaching changes in the system of government itself.

The likeness between these reforms and those initiated by the Popular Front Government in France was too close to be accidental. It was evidence, in the first place, of the immense attractive power of the French 'New Deal', itself partly inspired by the original New Deal across the Atlantic. In the second place, since the French Government bloc extended as far Left as the Communists, and the Belgian Government bloc

as far Right as the Catholics, while Mr. Roosevelt had behind him an unprecedented popular majority, the similarity of their economic reforms showed that the movement for better working conditions, including shorter hours, for a higher standard of life, and for closer public control of certain branches of capitalist activity was the product more of the world-wide circumstances of the time than of the accidents of party politics. It was the reaction from the depression, the fruit of its cruel lessons. The tide of social advance in the Western World did not creep slowly up the shore; through the successive phases of slump and boom the waves receded and returned, to drive forward their high-water mark yard by yard, not like an even ocean surf but like the broken tossing of a narrow sea.

Here and there the rising tide spent its effort against the groins and breakwaters erected by dictatorships and by the concentration of economic effort on the means of war. The devaluation of the gold-bloc currencies created special difficulties for the Italian dictatorship, since Signor Mussolini had pledged himself to defend the value of the lira at all costs, and had ordered his words to be graven in stone. By a royal decree-law of the 5th October 1936, however,

> 'in consideration of the urgent necessity of regulating the intrinsic value of the Italian currency by adjusting it more closely to economic relationships and to the value of the most important and widely used currencies in circulation in the principal world markets,'

the gold content of the lira was reduced from 7·919 grammes to 4·677 grammes of fine gold per 100 lire. It was provided, in addition, that by royal decree the value of the lira might be reduced by a further proportion of ten per cent. The Bank of Italy was authorized to revalue on the new basis its reserves of gold and foreign exchange, the increment being credited to the state.[1]

[1] No returns of the Bank of Italy were issued after the 20th October 1935, but in March 1937 it was announced that the Bank's reserve of gold had amounted on the 20th February to 3,959 million lire. This was, on paper, a distinct improvement on the last published figure of 3,027 million lire at the 31st December 1935, and was even slightly higher than the gold reserve of 3,936 millions disclosed at the 20th October 1935. At the old valuation, however,

Authority was given to suspend by decree the decree-laws relating to the control of capital and foreign exchanges. 'Not devaluation, but equalization' was the phrase used by Signor Virginio Gayda to describe this sensible erasure of the unfortunate Pesaro pledge. The lira, it was claimed, was merely being brought back to the international level that it had maintained from its stabilization in 1927 until the devaluation of the pound sterling in 1931. It was indeed being reduced, not to a franc basis, but to a sterling basis. The devaluation by approximately 40 per cent. undercut the gold-bloc devaluation by some 10 per cent. and, in addition, 'transit lire' were made available at specially cheap exchange rates (100 to the pound) for all expenses of travel or visit in Italy. 'There is no need', boasted Signor Gayda, 'for a special stabilization fund, with foreign contributions, as in France. No special defensive measures are required.' Import duties were simultaneously reduced on a wide range of commodities. The ban on dividends of joint-stock companies exceeding 6 per cent. was withdrawn, but was replaced by a special graduated tax, not applicable to colonial enterprises. A forced loan was raised on land and house property, owners of such real estate being obliged to contribute 5 per cent. of its value. The prices of primary necessities were fixed at their existing level for two years.

The devaluation of the franc resulted in a further reduction of the gold content of the Czech crown. In February 1934 Czechoslovakia had devalued her currency by $16\frac{2}{3}$ per cent., and had thereby secured a considerable improvement in external trade. But many people held at the time that, having regard to the much greater depreciation of the pound and the dollar, the devaluation had not been large enough, and there arose a strong political agitation for a further cut. The currency, indeed, was amply covered, and the Budget was balanced, but Czechoslovakia was feeling more and more acutely the competition of some of her rivals in external markets. She suffered particularly from the artificial stimulation of German exports through the use of blocked marks and

the gold reserve in February 1937 amounted to no more than 2,338 million lire. Hence the actual loss of gold in the sixteen months' interval had been nearly 1,600 million lire at the old parity.

the payment of export bounties. A fortnight after the French devaluation, it was decided to reduce the gold content of the crown once more, the new range within which it would be allowed to settle being 30·21 to 32·21 milligrams. These limits represented a total depreciation of 28·6 to 32·2 per cent. from the gold value ruling before February 1934. Monsieur Hodža declared that Czechoslovakia was ready to collaborate with the Western Powers in monetary policy, and that the new devaluation would be accompanied by the reduction of obstacles to international trade.

Immediately after the fall of the franc, Greece, Latvia, and Turkey decided to join the sterling bloc by linking their currencies with the pound. The drachma and Turkish piastre had previously been linked to the franc. The lat was restored to the exchange-rate on sterling that had ruled before the latter left gold in 1931. It was announced in Vienna on the 6th October that the price of gold in Austrian currency would thenceforward be based, not only on the gold-buying price of the Bank of France, but also on the prices ruling in various markets. This was generally interpreted as replacing the franc by sterling as the international standard of measurement and stability for the already depreciated schilling. Owing, however, to Austria's position as an importing country and her small capital, devaluation could only have disastrous results, so the Finance Minister and the President of the National Bank explained. As an alternative, the Government would consider assisting exporters in competing with their rivals from countries with depreciated currencies. Speaking in Parliament on the 11th February 1937, the Finance Minister declared that the economic situation in Austria was thoroughly favourable and was improving. Exports had risen, and the method of compensating exporters for losses due to devaluation in other countries had worked well.

Poland, who had forsaken the international gold standard at the end of April 1936, and had followed this up by suspension of the service on her external debt,[1] preferred to continue the artificial defence of her currency rather than devalue it

[1] See above, p. 384. Service was maintained on sterling loans, by reason of Poland's favourable balance of trade with the United Kingdom; but on the

and return to freedom of exchanges. Hungary, Lithuania, and Albania refused to participate in devaluation, and officially Yugoslavia joined in this refusal, but after the depreciation of the franc the dinar lost some 20 per cent. of its value on the unofficial exchange. On the 20th December, at the close of a conference held in Athens, the central bank governors of the countries of the Balkan Entente—Greece, Yugoslavia, Rumania, and Turkey—issued a statement defining their attitude towards the three-Power currency declaration.

'Considering that the present monetary understanding binding France, England, and the U.S.A., to which certain other countries have adhered, constitutes an important step towards clearing up the international monetary situation, and regretting their inability to adhere to it for the moment, the governors expressed their wish that the currencies of the principal Powers be stabilized on a definite basis in the near future in order that other countries, and particularly those of the Balkan Entente, may also join in the work of improving the world monetary situation.

'The governors . . . recognized the necessity above all that countries which had effected monetary alignments should lessen, and, as much as possible, abandon altogether the system of restrictions, and renounce progressively their clearing agreements, or at least make them less rigid.'

The devaluation of the franc gave rise to strong rumours that the reichsmark would follow it. German industrialists were said to be in favour of such a course, and an anticipatory boom started on the Berlin stock exchange. Dr. Schacht, however, decided otherwise. In part, no doubt, it was a question of prestige; Germany would have found it distasteful to follow, as if obediently, a move by the three great Western democracies concerning which she had not been consulted. Dr. Schacht, moreover, had consistently opposed devaluation on a number of economic grounds; he held that Germany would have to pay more for the raw materials which she needed, that the service of her external debt would become more burdensome, and that the barriers confronting her goods

4th March 1937 the Polish Government announced their inability to transfer the full interest of the 7 per cent. sterling stabilization loan of 1927 after the following April. For later coupons it offered the alternative of cash at 35 per cent. of their face-value, or 20-year funding bonds bearing 3 per cent. interest.

abroad would prevent her from securing compensatory advantages in export trade. Expressing these views in an address to the Central Committee of the Reichsbank on the 30th September, he declared that the German investor and worker should be able to rely on the National-Socialist Government's intention to maintain fully his purchasing power and the fruits of his labour.

'The heavy burden of debt resulting from the injustices of Versailles and the difficulty of obtaining supplies of raw materials force us to maintain this system. Only an amelioration of these things will make foreign currency control superfluous. . . . The Reich Government is prepared at any moment to participate in useful international negotiations which, while naturally maintaining national interests in accordance with the three-Power declaration, aim at a free international economic and payment traffic.'

In sum, the three-Power declaration, while bringing the currencies of the gold bloc, the sterling bloc, and the dollar bloc more closely into line with each other on the basis of purchasing power, and while relaxing in some measure the rigidities with which the lira was defended, did little immediately to break down the barricades that hemmed in most of the currencies of Central and Eastern Europe.

(c) *Exchanges after the Realignment*

The first reactions of London markets to the French devaluation were a swift rise in the sterling price of gold and a depression of the pound against the dollar. These two connected movements were obviously founded upon two assumptions: first, that the devaluation of the franc would induce a return of refugee capital from London to Paris; and, secondly, that partly for that reason the gold-bloc currencies would not fall as far against the pound as they would against gold. The rise of the dollar in terms of sterling was also due in some measure to the check imposed on American purchases of French gold, which had persistently depressed the dollar against the pound. In the dollar-franc-sterling triangle, the only fixed point of attachment to gold was now the American Treasury's buying price of \$35 an ounce; about this pivot the relative values of both the franc and the pound could move

with a certain freedom. The depreciation of the pound from an average of \$5·036 in September to an average of \$4·898 in October was therefore a sign of relaxation of a previous strain.

On the 29th September dealings in guilders and Swiss francs were resumed in London. The closing rates on that day (8·86 guilders to the £, and 21·46 Swiss francs to the £) indicated margins of depreciation amounting to 17½ per cent. and 29½ per cent. respectively. The following day the Bank of England offered to sell French francs at 96 to the £ for the benefit of operators requiring francs urgently, but on the 2nd October, when the Paris bourse reopened and free dealings in francs were resumed, the London 'control' offered francs at 103 and found the market unexpectedly selling French currency. The rate fell to 105¾—equivalent to a depreciation of 29¾ per cent. against gold—before the decline was checked by the 'control'. A few days later the pressure was reversed, as capital began to flow back to the Continent. A week after the resumption of dealings in the franc, the Bank of France return showed an increase of 7,250 million francs in the gold reserve (about £70 millions on the new basis), apart from the profits of revaluation. The discount rate was lowered from 3 to 2½ per cent., and on the 16th October to 2 per cent. The second week of the 'Blum' franc had produced a further increase of 5,000 million francs in the gold reserve.

Meanwhile the three-Power agreement had been strengthened on its technical side. On the 13th October the United States Secretary of the Treasury announced that the American authorities would sell gold for export to, or earmark gold for the account of, 'the exchange equalization or stabilization funds of those countries whose funds likewise are offering to sell gold to the United States, provided such offerings of gold are at such rates and upon such terms and conditions as the Secretary of State may deem most advantageous to the public interest'. Great Britain and France were forthwith named as complying with this condition. On the 24th November a supplementary statement authorized the sale or earmarking of gold on similar terms for Treasuries or Government fiscal agents, and Belgium, the Netherlands, and Switzerland were added to the list of beneficiary countries. Previously, the

Treasury had undertaken to sell gold for export only to countries maintaining an open gold standard. A similar understanding was reached between Great Britain and France. The Secretary of the Treasury, Mr. Morgenthau, described the system as 'a new type of gold standard' and as 'one more move towards our general objective—the restoration of world trade'. It was greeted with favour in financial circles, which regarded it, however, as a purely technical arrangement.

A new type of international monetary mechanism had certainly been set up, but not a new type of gold standard. The mechanism might perhaps be described as a stabilization of instabilities. While the new international co-operation did not alter the aims of national monetary policies, it prevented them from becoming dangerously competitive and jealous, and set up a technical collaboration capable of maturing gradually into a more permanent international system, and of being applied—as later events were to show—on occasions when currency ratios might have to be readjusted once again.

Moreover, it altered the function of gold in the international monetary system, or rather it ratified an alteration that had been proceeding by stages ever since 1931. The function of gold as an internal standard of value now almost disappeared. Belgium alone of the Western countries retained an open, two-way market for gold in exchange for currency; the fixed price of $35 an ounce maintained by the American Treasury was a buying price only, as far as the public was concerned—and, what was more, holders of gold in the United States were compelled willy-nilly to sell at that price. The role of gold was reduced to official international transactions, designed, not for maintaining fixity of exchanges, but for rectifying temporary or permanent deficits in balances of payments. A leading firm of London bullion brokers wrote in its review of the market in 1936:

> 'Gold movements have practically ceased to be a function of private arbitrage and are now merely complementary to the alterations in exchange rates which the various funds allow. This is the main positive result of the agreement.'

The new system was placed under strain early in its career; for the expected return of refugee capital to France did not

occur on a sufficient scale to secure the 'Blum' franc against the weakness that attacked it from time to time. The general political uneasiness of Europe was a constant 'bear point' for the franc. Further unsettlement was caused by the necessary repayment of the £40 millions loan made to the French Treasury by London bankers in the previous February and March, nine months having been its longest permissible currency. When this credit came to be liquidated, the Bank of France return showed a sudden drop of 4,000 million francs in the gold reserve. The repayment was the signal for a striking monetary adjustment in Great Britain. On the 15th December 1936 the Bank of England purchased from the Exchange Equalization Account £65 millions in gold, and on the same day the Chancellor of the Exchequer announced that the fiduciary issue (that part of the issue of currency not covered by metallic reserves) would be reduced from £260 millions[1] to £200 millions. Mr. Chamberlain explained that this action had been taken because, by itself, the increase of the gold reserve would have meant a very sharp expansion of the credit base, for which there was no justification. He added that there was no greater permanence in the arrangement than might seem desirable to the authorities. Its chief significance undoubtedly lay in the disclosure that the Exchange Equalization Account was over-supplied with gold. Net imports of gold into the United Kingdom in the twelve months ended November had exceeded £220 millions, and more was flowing in as the French credit was repaid.

This figure gave some indication of the rate at which refugee money had poured into London. It must, however, be considerably augmented to give the true rate, since the inflow of short-term capital was balanced not only by imports of gold but partly also by a deficit—estimated at £19 millions in the year 1936—on the international balance of current payments and by a simultaneous outflow of funds for investment in American markets. In 1935 and 1936, imports of capital into the United States from the United Kingdom totalled

[1] It had stood at this figure from the amalgamation of the note issue in 1928 until 1931, and from 1933 onwards. In 1931 it had been raised to £275 millions in order to offset the rapid outflow of gold.

$829 millions, including $342 millions of banking funds, $368 millions for the purchase of American domestic securities, and $116 millions for foreign securities. The United Kingdom supplied 31·4 per cent. of the imports of foreign capital into the United States, which totalled $2,607 millions net. Continental Europe was responsible for $1,222 millions, and the rest of the world—chiefly Canada, Latin America, and the Far East—for about $555 millions. This gigantic migration of capital was financed, in the mass, by the movement of gold. In the same period of two years the net import of gold into the United States totalled $2,856 millions.

With a speculative investment movement added to the precautionary withdrawal of refugee funds, the strain on the franc continued with little relief. The Government renewed their efforts to secure a return of French capital. Hoarders or exporters of gold, who were to have been mulcted of profits from devaluation by being paid only the old rate for their gold, were offered, in lieu of cash, three-year bonds bearing 3½ per cent. interest, redeemable in three years' time at 140 per cent. On the same day as this concession was announced (the 16th December), holders of 'baby bonds' were offered the right of conversion into nine-year 4 per cent. bonds, also redeemable at 140 per cent. This generosity was held necessary because investors (among whom were many small savers and trade unions) had been persuaded to lend their money to the Government on the assurance that the 'Poincaré' franc would be maintained. On the 5th January an amnesty from penalty was extended to those who had failed to declare their holdings of gold or foreign currencies under the devaluation laws, but who subscribed before the 31st January to the 3½ per cent. bonds redeemable at 140 per cent. at the end of three years. The rate of interest on National Defence Bonds was simultaneously raised from 3 to 4 per cent.

All through January and February Monsieur Auriol's repeated assurances against further devaluation, and the temptations—extended once more—to investors to bring back their capital to France, waged a rearguard campaign against the rumours that a renewed depreciation of the franc could not be avoided, at least to the maximum limit authorized by the law

of the 2nd October. On the 28th January the discount rate of the Bank of France was raised from 2 per cent. to 4 per cent., but this did not check the pressure. On the following day negotiations were concluded with a British banking syndicate for an advance of £40 millions to the French state railways. The loan was to be for ten months, was to carry interest at $3\frac{1}{2}$ per cent., and was secured—so it was reported—on gold. The direct effect of such a transaction would be, of course, to strengthen the franc against sterling for the time being, but the relatively onerous terms, the smallness of the amount compared with the market's expectations, and the fact that such an advance was required at all so soon after the devaluation had replenished the French Treasury's resources, caused a renewal of the depression about the future of the franc. The depression was intensified by the publication of the return of the Bank of France for the week ended the 28th January, which revealed that the Bank had lost 3,000 million francs of gold. The interpretation reasonably adopted by the market was that the 10,000 million francs with which the exchange stabilization fund had been credited were already exhausted. In the eight weeks ended the 18th March net imports of gold from France into the United Kingdom alone totalled £45 millions. The greater part of this transfer, presumably, was required to furnish the security for the railway loan.

Already, however, there were signs of a turn of the tide. Investors were reassured by a change in the emphasis of French Government policy. Addressing the National Council of the Socialist Party on the 14th February 1937, Monsieur Blum declared that they were obliged to act with prudence and to go forward step by step. The necessity for a pause had shown itself. This statement he elaborated in the Chamber on the 26th.

'The lengthy economic crisis has caused a certain amount of demoralization. France is living in a state of closed economy, almost autarky.

'To attain normal prices we must balance supply and demand, wages and prices. Everything will be useless if the national economy receives fresh shocks. Therefore, we pause.

'When we have derived benefit from the pause, we will start

on the People's Front programme again. Nothing will be submitted to the Chamber unless agreed upon by all the parties in the People's Front.'

The 'pause' received positive expression in a new financial policy announced after a Cabinet meeting on the 5th March. The policy had six main points. First, the three-Power declaration was reaffirmed as the basis of France's monetary policy. Secondly, the Bank of France would buy gold at the open-market price without reference to the seller's identity, and the importation, export, and buying and selling of gold would be freed from restraint. The penalization of speculators in gold and foreign exchange was thus abandoned. The Bank of France opened its counters for the unrestricted purchase of gold on the 8th March, fixing the rate, after some fluctuation, at the equivalent of about 45 milligrams to the franc, the mid-point of the limits fixed by the Devaluation Law. Until the 5th March the exchange value of the franc had been maintained at the equivalent of 46 milligrams. The relaxation of official support caused a sharp decline in the rates on London and New York, and at one moment on the 6th the franc slumped to 108¼ to the pound. Afterwards it settled between 106 and 107 to the pound. This change in the manner of regulating the exchanges was associated with the third point in the new financial programme, namely, the appointment of a committee of experts to manage the Exchange Equalization Fund. The committee, which was to have regard to the needs of commerce, of price stability, and of the Government bond market, was to be composed of Monsieur Charles Rist, Monsieur Paul Baudouin, Monsieur Charles Rueff, and Monsieur Labeyrie, the Governor of the Bank of France.

Fourthly, any governmental expenditure beyond the credits voted in the Budget was to be prohibited, except so far as was necessary to readjust the salaries of the lower grades of civil servants. Fifthly, Treasury requirements from the lending market were to be limited to 8,000 million francs during the remainder of the financial year. Sixthly, and perhaps most important of all, a national defence loan was to be issued forthwith and was to be the only long-term public issue for the Treasury in the current year. Subscribers were to be

guaranteed repayment in dollars, sterling, or francs, at their own option. The Bill to authorize such a loan abrogated four clauses of the Devaluation Law restricting dealings in gold or its export or import, and applying penalties for non-disclosure of gold holdings. The Bill further provided for compensation to those who had already surrendered their gold at the old rate, authorizing the Bank of France to pay the difference between the amount paid and the average prices for gold fixed by the Bank on the first three days of the new monetary régime. The penal clauses of the Devaluation Law thus never went into practical effect. The Senate inserted in the Defence Loan Bill a proviso that the loan should not exceed the amount of the extraordinary armament expenditure contained in the Budget —10,500 million francs.

The first instalment of the loan was issued on the 12th March. It consisted of 5,000 million francs in $4\frac{1}{2}$ per cent. bonds, redeemable within 60 years, which were offered at a price of 98 per cent. Interest and capital were to be payable either in French francs in France or in Swiss francs by the Bank for International Settlements through appointed agents. The intention of paying interest and redeeming capital in sterling and dollars was abandoned—apparently at the instance of the British and American authorities, who did not want their own capital markets congested with the loan. The United States Treasury was also anxious to avoid any charge of complicity in evasion of the Johnson Act, which forbade American lending to countries in default on their obligations to the United States. However, the link with the pound and the dollar was preserved by quoting the values of the coupons for interest and the scrip for the capital in terms of those currencies, as well as francs, and by providing that, in the event of any depreciation of the franc against sterling or dollars, bondholders might cash their coupons in French or Swiss francs at the current rates of exchange on London or New York. The sterling and dollar designations were on a scale equivalent to exchange rates of 106·96 francs to the pound and 21·901 francs to the dollar, giving a cross-rate of $4·884 to the pound.

The loan was an instant success, being heavily over-subscribed on the day of issue, and was followed by a second

instalment of 3,000 million francs, issued on the 16th March. This was also immediately subscribed, though there was evidence that the loan was not digested as rapidly as it was swallowed. The success of the loan had a reassuring psychological effect, and for some time the exchanges were much more favourable to the franc.

Partly by reason of the disturbance of international politics, the favourable interval did not last long. Nevertheless, it was a moment to take stock of the effect of devaluation on the French economy. Until the 'pause' and the issue of the defence loan, its financial outcome had been disappointing. More gold had been lost, instead of recovered, and the Government's worst enemy was still their need to borrow in order to pay their way from month to month. On the other hand, bank rate was down and the price of money easier. Unemployment was down by 17 per cent. compared with the same period of 1936, and industrial production had risen by 9 per cent. since September. The critical factor was perhaps the movement of prices. In six months the wholesale price index had risen by 31 per cent., thus completely counteracting the depreciation of the franc; while the rise of 10 per cent. in the cost of living had eaten up a good proportion of the higher wages, which had themselves done much to raise the wholesale price-level. Nevertheless, the greater rise in wholesale than in retail prices spelt larger profits as well as a higher standard of life. The balance of external trade had moved sharply against France; the excess of imports in March 1937 was 1,490 million francs against 672 million francs in September, and 711 million francs in the previous March. This, of course, took no account of the improved receipts from the tourist trade.

After the devaluation of the franc the kaleidoscope of currency exchanges resolved itself into a new pattern, more closely comparable with the pattern before the depreciation of the pound in 1931 than with anything that had intervened. The dollar moved to a position a few points away from its old parity with sterling, the lira closer still. The currencies of the former gold bloc sank to within a margin of 26 per cent. (the guilder) to 14½ per cent. (the French franc) of their former sterling parities. These margins roughly represented the degrees to

which those countries had been able to push deflation during the period of four to five and a half years in which Great Britain and the United States had been relieved of purely monetary compulsion to follow the same course. The Scandinavian members of the sterling bloc, on the other hand, had pegged their currencies at levels lower by 6½ to 18 per cent. than their old rates on London. The yen, the peso, and other extra-European currencies were even further depreciated. The barricaded currencies of Central and Eastern Europe still maintained officially their former relation to gold, but the discount of over 50 per cent. on registered marks was a typical index of the level to which they might be expected to fall (for purely commercial reasons) if the barricades were taken down. Had that actually occurred, of course, a far more severe depreciation might have been expected by reason of the exodus of capital which the countries concerned—particularly Germany—had cause to fear. The following table shows the rates of exchange of various currencies on London on various dates: before the franc was devalued; on the earliest date on which all the gold currencies, including the lira, were again quoted in London; and six months after devaluation.

London Rates of Exchange

(Spot rates: mid-point of day's range)

London on:	*Usance*	*Pre-1931 parity*	*24th Sept. 1936*	*6th Oct. 1936*	*27th Mar. 1937*
New York .	\$ to £	4·86⅔	5·06¼	4·90 15/16	4·88⅝
Paris . .	Fr. to £	124·21	76 29/32	105 3/32	106⅜
Brussels . .	Belgas to £	35·00	29·97	29·19	29·01
Milan . .	Lire to £	92·46	64 7/16	93⅛	92 25/32
Zürich . .	Fr. to £	25·22½	15·56	21·33	21·44½
Amsterdam .	Fl. to £	12·107	7·49	9·29	8·92½
Berlin . .	Rm. to £	20·43	12·60	12·22	12·14
Registered marks	% disct.	. .	44½	46½	51½
Vienna . .	Sch. to £	34·58½	26⅞	26½	26
Oslo . .	Kr. to £	18·159	19·90	19·90	19·90
Stockholm .	Kr. to £	18·159	19·40	19·40	19·40
Kobe . .	d. per yen	24·58	14 1/32	14 1/32	14
Buenos Aires .	\$ to £	11·45	17·77½	17·55	16·24½

The new rates were undoubtedly more natural—that is to say, they accorded more clearly with relative purchasing power—

than those in force before the 26th September. In this fact lay perhaps the principal direct benefit of the realignment to world commerce.

The purpose of the three-Power declaration, however, had not been achieved with this negative correction of monetary disorder. An essential clause in it had been the statement that the success of the monetary policy was linked with the development of international trade, and that the signatory Governments attached the greatest importance to the taking of action without delay 'to relax progressively the present system of quotas and exchange controls with a view to their abolition'.

The advance made in this direction was disappointing. Both Italy and France, it is true, took the opportunity of the cheapening of their currencies to relax tariffs and quotas.[1] On the 5th October 1936 the French Government issued a series of decrees reducing by 25 per cent. the general rates of import duty on goods subject to quotas, and by 15 to 20 per cent. those on imports not subject to such restrictions; abolishing 106 import quotas out of the 750 then in force; and setting up a Customs Commission whose purpose was to be 'to avoid any unjustified rise in prices by means of the introduction of greater quantities of competing foreign goods on the French market'. A further decree abolished the compensatory (or anti-exchange-dumping) duties applied to goods imported from or produced by Australia, Egypt, India, New Zealand, South Africa, Paraguay, or Argentina. The maximum compensatory duty on goods from China or Japan would be 10 per cent. A Cabinet report to the President of the Republic expressed the hope that the lowering of tariffs would pave the way for the negotiation of fresh commercial treaties, to the advantage of the French exporter. In a public proclamation the Government declared that they had in their hands the means to prevent any undue increase in prices by lowering customs duties, and that they were already making the necessary adjustments. This minatory emphasis on the price-levelling purpose of the cuts in tariffs and expansion of quotas not unfairly indicated the limits of the immediate French contribution to freer trade. In essence it did little more than compensate for the increase

[1] See above, p. 422.

in the prices of competing foreign goods through the cheapening of the franc.

The disappointment, however, lay rather in the quick dying-down of the ripples on the wider surface of world trade policies. An opportunity for furthering the general purpose of the three-Power declaration soon occurred, in the meeting of the League of Nations Assembly in October. A resolution was submitted to the Second (Economic) Committee of the Assembly, noting with satisfaction the tripartite monetary declaration, and urgently recommending the states concerned, as an essential condition of final success in stabilizing economic conditions and raising the general standard of living, to reduce excessive obstacles to international trade and communications, and, in particular, to relax and as soon as possible to abolish the existing system of quotas and exchange controls. In the subsequent debate a number of important statements of policy were made. For the United Kingdom, Mr. W. S. Morrison agreed that the first objective must be to restore a situation in which the purchaser could buy what he wanted, the debtor could pay what he owed, and the tourist could go where he wished, without encountering impassable obstacles such as quotas and currency control. The United Kingdom Government, having found that the proper adjustment of currency relations to the price structure had been accompanied by a great improvement in internal trade, saw no reason to doubt that similarly good results would follow from devaluation in the gold bloc. Their action on the occasion of that devaluation had been by no means easy, and would never have been taken had they been obliged to take account of particular interests at home. They would continue, to the limit of their capacity, to carry out the non-exclusive trade policy which they had hitherto adopted. They would undoubtedly be faced by the strongest pressure, from particular interests at home, to take measures to counteract the intensified competition that would result from the devaluation of other countries' currencies. The pressure might become irresistible if they could not show that the Governments of the devaluing countries were for their part withdrawing their exceptional restrictions. The best line of advance towards more general liberation of

trade might be by way of bilateral negotiations on the basis of the most-favoured-nation clause.

Monsieur Bastid, the French Minister for Commerce, described the French tariff reductions as a purely unilateral gesture intended to mark the Government's desire to combat a rise in internal prices and to set an example of moderation. They were drawing up a new customs tariff based on the classification adopted by League experts, from which quotas were excluded. It plainly could not operate to the full unless it were accompanied by a general disappearance of the control exercised over commerce and foreign exchange. The Netherlands representative said that his Government would be able to abandon quotas for those countries which had done something in this direction, but they must make a reservation concerning those that persisted in maintaining strict currency control. Monsieur Stucki, for Switzerland, announced that he had come to an agreement with the French Minister for National Economy for a Franco-Swiss trade convention. He added that he was prepared to enter into similar agreements with other countries, and that Switzerland would give tariff and quota relief to all who were prepared to extend equal treatment to Swiss exports, tourist traffic, and debts to Switzerland.

A few days later, on the 19th October, the Council of the International Chamber of Commerce issued a declaration similarly urging a relaxation of trade barriers.

> 'Not only is the time ripe for a progressive abolition of the numerous so-called emergency trade restrictions and increased customs tariffs imposed during the depression, but failure to carry through concerted action for this purpose will undermine the exchange stability aimed at by the signatories of the tripartite monetary agreement and will, as a further consequence, create the serious risk of a new series of currency depreciations, an intensification of economic warfare, and thus create a grave menace to the maintenance of peace.'

The world, in short, did not want for fair resolutions in the currency New Year. In too great a degree, however, these suffered the traditional fate of good intentions. The efforts at

a gradual liberation of trade, espoused most notably by the United States, which characterized the year 1937, lie outside the historical scope of this book, but at least it may be said that their practical outcome was commensurate neither with the magnitude of the task nor with the opportunity presented by the realignment of currencies.

XII

THE RISE IN PRICES AND THE ARMAMENTS BOOM, 1936–7

(a) *Commodity Prices and Restriction*

THE background of currency realignment and of the efforts towards freer trade was the rise of prices that gathered momentum in the middle months of 1936 and reached its peak in March and April 1937. In a little over six months the price of wheat rose from 85 cents to 134 cents in the Chicago pit. Copper prices rose by roughly 40 per cent. in the last nine months of 1936, and three months later were nearly half as high again. Tin rose from £256 to £300 a ton in a single fortnight of March 1937. These instances were exceptions, of course; the various composite indices of wholesale prices moved much less sharply. In the United States the annual average of wholesale prices rose by only one point between 1935 and 1936, from 80 to 81 per cent. of the 1926 average; even so, the trend in the latter half of 1936 was such that it carried the index to an average of 87 for the first three months of 1937. A similar comparison for the United Kingdom shows a much steeper rise: the indices for the 1935 average, the 1936 average, and the average of the first three months of 1937 were respectively 89, 94, and 105, on a base of a 100 for 1930.

In France the movement was more spectacular. In January 1936 the wholesale price index (1913 = 100) stood at 359. After June, when it was still only 378, there began a steady increase which brought it to 420 in September. Then came devaluation, and by the January of the following year the index was 538. In France the direct effect of devaluation was reinforced by the increases of internal costs imposed by social legislation. An interesting comparison may therefore be made with the price movements in the Netherlands and in Switzerland. In the former country there was no substantial change in the monthly index before October, in the latter none before September 1936. Between September and the following

March, the Netherlands index rose by roughly 20 per cent., the Swiss index by somewhat less, whereas the French wholesale price index rose in the same period by almost one-third, on top of a considerable rise in the summer months of 1936. One other comparison may be significant. In Germany the official index of wholesale prices did not move by more than a single point throughout 1936, and although the upward trend from year to year was continued there was no noticeable rising curve on the short-term scale until the last two months of 1936 and the first two of 1937.

After March 1937 there was a sharp recession of wholesale prices all over the world, which affected almost every commodity entering into international trade. The causes of this recession throw some light both on the causes and on the effects of the earlier advance. Undoubtedly a major influence was the pricking of a speculative bubble. An unprecedented volume of speculative capital was available for temporary investment in commodities and in shares whose value turned on commodity prices. The instability of exchanges, the discrediting of foreign bond investments, the anxieties of capitalists in face of 'New Deals', the overriding fear of war—these and other forces had brought into existence a huge volume of liquid capital capable of moving rapidly from one centre to another, and shunning permanent investment. A portion of this 'hot money' seeped into commodity markets. Such speculative influences exaggerated the sharpness of the price-movement, both in its upward and in its downward phases.

Moreover, it was characteristic of such a speculative boom that psychological factors were as powerful as material factors both in promoting and in ending it. Two important psychological factors intervened against a further rise in prices during the first half of 1937.

The second in point of time and the more prolonged in effect was the so-called gold-scare. The scare owed its origin to the realization that the high price of gold, which had automatically followed devaluation, was encouraging a greatly enlarged output of the metal, and that all this new gold rapidly became buried in the vaults of one or two creditor countries, at ever-mounting cost to their central banks and treasuries.

Theoretically, this trouble could be overcome in either of two ways: through an increase of commodity prices in proportion to the increase in the price of gold, or through a reduction of the price of gold towards the existing level of commodity prices. A reduction of the official price for gold in any country —and this, it was rumoured during the scare, was imminent in the United States—would have been regarded as evidence that the continuance of bull speculation in commodities was a mistake. Hence, in so far as it was a by-product of the gold-scare, the fall of prices in the early months of 1937 was due to the failure of prices to rise far enough in earlier periods.

The second adverse psychological factor was also associated with the suspicion that those holding financial and economic power believed prices to be already high enough or too high. On the 9th March 1937 President Roosevelt warned the people of the United States, in a radio address, that an economic catastrophe comparable with that of 1929 threatened in the not-distant future. On the 2nd April he reinforced this warning with a much more explicit statement. He referred to the possible danger contained in the want of balance between the rapid advance of prices and production in 'durable goods' industries, and those in 'consumer goods' industries. The prices of steel and copper, he said, had advanced beyond any figure that could be justified by recent increases of wage rates. He did not suggest, however, that his Government could or should take action save by a shift of emphasis in the nature of their own purchases from durable to consumer goods.

Although the President did not indicate precisely how even this palliative would be applied, his statement had a decisive psychological effect on American markets, and, by reaction, on markets in other centres. It was largely because the financial structures of commodity markets had already been weakened by this blow that they suffered so severely from the impact of the British Budget, introduced on the 20th April. Neither in its original nor in its amended form was the National Defence Contribution directed against commodities; it applied to all kinds of profits. But the recession that it caused on stock markets had a prompt reaction on commodity markets,

partly because speculators caught in trouble in the one liquidated their commitments in the other, partly because the whole episode was taken by many people as a signal that the peak of the boom had been left behind.

The figures did not bear out President Roosevelt's allegation with any decisiveness. Between March 1936 and March 1937 the index of factory employment in the United States had advanced in the durable goods industries from 80·1 to 95·9 per cent. of the 1923–5 average, and in the non-durable goods industries from 95·8 to 106·1 per cent. Thus the former group was merely making up the start that it had given to the latter in the earlier phase of recovery. The industrial production figures did not tell quite the same story. In the same interval of twelve months, the index (on the same base) for raw mineral production[1] rose from 97 to 127, an advance of over 30 per cent., while the index for manufacturing production rose from 93 to 117, an advance of less than 26 per cent. Yet there were also consumption goods industries that made a showing well beyond the average: cotton consumption rose by 36 per cent.; the manufacture of boots and shoes advanced from 118 to 148 per cent. of 1923–5 levels; while the cigarette industry was operating in March 1937 at well over twice the average pace of 1923–5. Thus there was no decided evidence in favour of the view that capital goods industries had run far ahead of consumption goods industries in the United States.

Nor was there much more evidence to support a similar view of affairs in the United Kingdom. In the year ended March 1937 the Board of Trade index of industrial production (1930 = 100) rose from 123·2 to 131·9, an advance of 7 per cent. In the same period the monthly output of pig-iron rose by about the same percentage, and the monthly output of steel by some 13 per cent. More significant, perhaps, was the fact that the steel output was over 38 per cent. higher than the average of 1929. The reference to steel, however, as the first of the capital goods industries might be misleading; for the output of automobiles, which provided a market for a great quantity of steel, was running at well over twice the height of the levels of 1929.

[1] Covering coal and anthracite, petroleum, iron ore, zinc, lead, and silver.

These British and American statistics may be usefully compared with those of two countries very differently placed, France and Germany. The total index of industrial production in France (1929 = 100) rose from 72·7 to 74·8 in the twelve months ended March 1937, an advance of less than 3 per cent. The output of steel, in the same period, rose by over 17 per cent., but was still only a small fraction above the average in 1931. In Germany, on the other hand, the output of steel, though rising by only a very small fraction in those twelve months, was, as in Great Britain, well ahead of the monthly average even of 1929. The German index of industrial production (1929 = 100) rose from 100 in March 1936 to 111·9 in March 1937. This movement was compounded of an advance from 103·5 to 113·3 in the 'investment goods' section and an advance from 76·1 to 101·4 in the 'consumption goods' section. Hence, even allowing for a considerable latitude in the interpretation of 'durable goods', 'capital goods', 'consumers' goods', and so on, the statistics gave no emphatic support to the view that in the major industrial countries there had been a sudden or severe distortion in the direction of demand for 'durable' products.

What the proponents of this view had in mind, apparently, was the more rapid advance of wholesale than of retail prices, and the more rapid advance of wholesale prices in a certain group of commodities—headed by metals and comprising most industrial raw materials—than in others, chiefly foodstuffs and materials entering more or less immediately into private consumption. These divergences were an unmistakable fact which needed neither elaborate evidence nor special explanation; for it was but the natural reversal of the trend that had been so much deplored during the downward phases of the boom-slump cycle.

These general considerations, the various statistics quoted, and the contemporary warnings by statesmen and economists of the danger of a relapse like that of 1929, suggest a comparison between the price-levels of 1929 and those of 1936 and early 1937. The comparison is seriously complicated by the changes in currency ratios, and the depreciation of many currencies against gold. It seems best, for a number of reasons,

to take as the initial basis of comparison the course of prices expressed in sterling. The first reason is that the pound sterling had maintained for much longer than either the dollar or the franc its flexible relation to gold. Secondly, the 'sterling area'—that is to say the group of countries whose currencies were formally or informally linked with the United Kingdom pound—covered a very large part of the world and included countries as different in economic character as the United Kingdom, the Scandinavian countries, Australia, India, and the African colonies. Thirdly, the greater part of the world's free supplies of many important commodities was produced and marketed within that area.

In 1936 wholesale commodity prices in Great Britain averaged only 78·8 per cent. of their 1929 level,[1] in spite of the presumed effect of the abandonment of the gold standard in raising the national price-level. Although every year since 1932 had shown an advance, the rise had been slow. By March 1937 the index had risen to 94·4 per cent. The relation of 1937 prices to those of 1929, however, was far from uniform between the different groups of commodities. For textiles it was only 80·5 per cent., for cereals and meat 96 per cent., for other foods 82 per cent.; it was the figure for minerals—118·4 per cent.—that brought the average so close to that of 1929, and well above that of 1930. In the United States, although the general position attained in respect of dollar prices was very much the same, the spread was much narrower. The total index for March 1937 stood at 92·1 per cent. of the 1929 average, its components being: raw materials, 92·2 per cent.; semi-manufactures, 95·4 per cent.; finished goods, 91·4 per cent.; and farm products 89·6 per cent.

Although, however, prices had returned so close to 1929 levels in the two greatest industrial-exporting countries in the world (as they had likewise, when expressed in local currencies, in many primary-exporting countries like the British Dominions), no contemporary evidence yet proved that the long-term fall of prices, which was among the outstanding economic phenomena of the post-war period,[2] had been brought to an end. There had been little or no price-inflation

[1] The indices used are those of the *Economist*.

[2] See above, p. 34.

to mark the boom phase of the cycle in 1929, whereas there was certainly a measure of price-inflation in 1936 and the early months of 1937; yet prices in the latter period remained definitely below the levels of 1929 in the two chief currency areas in which there had been the longest time for the fall of the currency against gold to be reflected in higher local prices. To the sterling and dollar areas could be added Japan, where, in spite of the depreciation of the yen, not only against gold but even by a considerable fraction against sterling, wholesale prices in March 1937 were still less than 95 per cent. of the average for 1929. In countries that had maintained a constant ratio between their currency and gold, and in others that had comparatively recently sought the relief of depreciation, a 1929 standard of prices remained well beyond the horizon. The French wholesale price index was still 12 per cent. below the 1929 average, and the German index 22 per cent. below.

This apparent continuation of the long-term trend downwards was not, perhaps, specially surprising. For two of the main forces underlying that trend were reinforced rather than checked by the depression: the restriction of international trade in raw materials and foodstuffs as well as finished articles, and the cheapening of the processes of production by technical invention and discovery. While the gold value of world trade fell by two-thirds in the course of the slump, in no year did its volume fall below 74½ per cent. of the 1929 amount; yet even in the last quarter of 1936 the percentage was still below 92. The advance of technical economy and discovery is less easy to illustrate from statistics, though examples could be chosen in almost any industry, whether primary or secondary. But its force was proved by one of its most striking symptoms—the increasing relative importance, in national economies, of services of all kinds, gratifying demand which could arise only after basic material needs had been satisfied.

It was widely argued that the increased output of gold, and the revaluation of gold reserves at figures which vastly enlarged the scope for currency expansion, would serve to reverse the long-term tendency of prices to decline. The

argument was greatly weakened by the fact that the supplies of new gold, instead of exercising their effect on the general world price-level, were largely concentrated in one or two countries where they became 'sterilized'. This state of affairs might, of course, be altered by a redistribution of gold, or at least a redistribution of the faculty of acquiring gold. But this implied either radical changes in national fiscal and economic policies or a large-scale resumption of international lending, and neither of these solutions seemed likely in practice.

A second general conclusion to be drawn about the state of the world prices at the beginning of 1937 was that 'accidental' influences had undoubtedly reinforced an upward cyclical movement. The intervention of speculators has already been mentioned. For wheat and other grains, a dominating influence was the droughty conditions in North America in two succeeding seasons, reinforced in 1936 by the comparative poverty of the European crop. Among the 'accidental' influences must be reckoned also the various schemes of organized restriction of output or exports that affected the greater number of commodity markets.

Another vital factor was at once distinct from the business cycle, a cause of one of its phases, and a result of an earlier phase. That was the armaments boom. The depression helped to generate the competition in arms in several ways. Bad times caused bad feelings, and bad feelings caused fears which sought protection behind the ramparts of arms. The fall in prices and the drying up of the stream of international capital brought about an enhancement of economic nationalism, which in turn inflamed political nationalism. In the opposite direction of causality, the armaments expenditure helped to raise prices in two main ways. It was one of the means whereby the vicious circle of rising unemployment and falling purchasing power was broken; that is to say it was one of the stimulants of reflation, which spread through the whole economy and therefore involved a higher price-level all round. But it was also to be regarded as an economic force by itself, distorting the general price-level by abnormally raising the prices of the articles that entered into the manufacture of munitions and equipment for war. How potent these different

forces were in bringing about the rise in average prices is best considered by examining the course of prices in a number of leading trades.

Wheat.

No commodity, perhaps, underwent so violent a reversal of adverse fortune as wheat. On the 10th June 1936, No. 2 winter wheat (nearest future) stood at $84\frac{5}{8}$ cents a bushel in Chicago. A little over six months later it had risen to $134\frac{1}{4}$ cents a bushel, an increase of nearly 60 per cent. The advance was all the more remarkable in that the wheat market had remained uniformly depressed for some six years. Although the season 1935–6 was the most favourable, in point of price, since 1928–9, it was disappointing when wheat was compared with certain other raw commodities. The requirements of importing countries continued to fall; at 510 million bushels, the figure was the lowest recorded since the War of 1914–18. The exportable surplus of the great producing countries, however, was also abnormally low, partly owing to bad weather, partly owing to increasing home consumption, especially in America. The result of the year's trading, up to July 1936, was to reduce the carry-over of exportable stocks from 367 million bushels to 244 million bushels—the lowest figure since 1927.

Hence, when the crop year 1936–7 began, the statistics were emphatically on the side of higher prices. Harvest weather soon reinforced them. By early October it was estimated that the European crop (outside Russia) would be 78 million bushels lower than in 1935, the North American crop 45 million bushels lower, the North African crop 16 million bushels lower, and the combined crops of India, Japan, Turkey, and Chosen (Korea) 27 million bushels lower. It was too early to estimate the prospective crops of the Southern Hemisphere, but Northern countries were apparently in need of 166 million bushels more wheat than they had imported in 1935–6. Hence it seemed that unless the Southern Hemisphere crop, together with exportable supplies from Russia, increased by some 290 million bushels there must be a further inroad on the world's already scanty reserves.

Argentina had had an exceptionally good crop in 1936, and might be able to make up at least 100 million bushels of the 1937 deficiency. But Australia, which had moderate harvests in both seasons, was not in a position to provide the rest, nor was there any sign of Russia's returning to the role of large-scale supplier of wheat to Western Europe. On the importing side of the scale, both Italy and Germany had boasted that they had rendered themselves self-sufficient in bread grains. Their achievement in this direction, however, was largely based on the succession of good harvests up to 1934; the reversal of this good fortune revealed its instability. The reserves that Germany had accumulated had been largely exhausted by the time when the poor 1936 crop was harvested. Moreover, the shortage of fats had led to a larger consumption of bread, under official encouragement. Germany's policy in the 1936–7 season appeared to be to import coarse grains rather than wheat, in order to reverse that process through increasing the output of animal foodstuffs. Her imports of wheat were nevertheless considerable, though not so large as those of Italy. The product of these factors was a sharp rise in the price of wheat, and the rapid exhaustion of Argentina's exportable surplus. On the other hand, the high price caused a curtailment of Eastern purchases, and this provided a certain counter-weight.

The restriction of output by international agreement had no direct effect upon the rise of wheat prices in 1936–7, though it is possible that, but for the international agreement, acreages of wheat, especially in the United States, might have been higher than they were in 1935 and 1936. Those two seasons, in fact, saw the complete liquidation of wheat restriction. The only major factor that remained unreversed in the world wheat market was the protectionism of importing countries.

Rubber.

Rubber vied with wheat in the sharpness of the advance in its price. 'Sevenpenny Rubber' was the title of a leading article in a London financial newspaper on the 11th February 1936. Thirteen months later, the same journal headed an article 'Shilling Rubber'. In 1934 and 1935 the main cause

of the comparative firmness of rubber prices had been the organized restriction of production, which brought about in the latter year a reduction of world stocks by 100,000 tons; but so far was restriction from having caused the rise in 1936 and the early months of 1937 that the signal for the advance beyond a shilling a pound was actually a decision of the International Rubber Regulation Committee to raise the permissible export quota for the second half of 1937 from 85 per cent. to 90 per cent. of standard tonnages. In the first half of 1936 the quota had been 60 per cent.; for the second half it was raised to 65 per cent. In October the decision was taken to add another 5 per cent. for the first half of 1937, and the immediate reaction of the market was to boost the price to 8*d.* a pound, the highest price recorded since February 1930. In December the quota for the first quarter of 1937 was raised to 75 per cent., and that for the second quarter to 80 per cent. This was again followed by a rise in prices; on the 18th December the tenpenny mark was reached for the first time since October 1929, and within a fortnight another penny was added. On the 26th January 1937 the Committee decided that the export quota for the third quarter of the year should be 85 per cent., from which figure it was advanced in March to 90 per cent.

One of the major causes of higher prices was the doubt whether producers could supply enough rubber to fill their permissible quotas. One authority declared that no more than 75 per cent. of the basic tonnages could actually be produced in 1937; a more widely accepted estimate was 80 to 90 per cent. While the international scheme banned the planting of new land, a large proportion of the existing acreage had been planted twenty-five to thirty years previously, and was past its prime. The process of improving yield by budding and heavy manuring was still in an experimental stage The restriction agreement had permitted the replanting of one-fifth of the area under cultivation, but the new trees would not be ready for tapping until five or six years had passed, and would not be in full bearing for ten years. These considerations applied to the estate rubber industry in Malaya and the Netherlands East Indies, and not to smaller producing areas

such as Ceylon, Siam, and Sarawak, whose basic allowances were thought to conform closely to their true potential outputs.

A good deal turned on the productive capacity of the native areas. Cautious observers, while admitting that these areas had a hypothetical capacity of perhaps 350,000 tons, thought that in any likely circumstances they could produce little more than their quota of 250,000 tons. Their costs of production were undoubtedly very small; for they continued to export large quantities of rubber despite the imposition of an export duty designed to reduce the net return to about 6 cents per half-kilogram. In February 1936 this duty was 32 cents per kilogram; after the rise in the guilder-price of rubber as a result of devaluation it was increased to 47 cents. The price in Batavia being then 59 cents, very nearly four-fifths of the gross return was being deducted in taxation, though a large part of this impost was returned to the native producers, by way of education in the use of more effective methods and through other channels. Rising prices were followed by still higher taxation, a peak of 59 cents per kilogram being reached early in December. At the beginning of 1937, however, the change from restriction by taxation to restriction by individual licence in the native areas was at last completed. If, then, the estate producers of Malaya and the Netherlands East Indies could produce 85 per cent. of their allowances, and the remaining areas 100 per cent., the productive capacity of the rubber industry at that period appeared to be about 1,250,000 tons a year, including 100,000 for areas outside the scheme. The world absorption of crude rubber in 1936 amounted to 1,020,788 tons, a figure higher than any previously recorded. At the beginning of 1937 the world absorption of rubber (that is to say, consumption *plus* any net increase of consumers' stocks) was running at the rate of about 90,000 tons a month; if it rose to 100,000 tons a month it would require practically the whole apparent maximum output of the world.

'Rearmament', wrote a leading London firm in their review of the rubber market in 1936, 'means a much accelerated demand for rubber. . . . So long as there is any fear of international strife, any importing country will naturally desire to have some stock in hand against the possibility of being unable

to secure further supplies'. Dr. Colijn made a similar assertion to the Netherlands Lower Chamber on the 12th February 1937. The building up of large stocks by several countries as part of their armament programme, he said, was an important factor in the rise in the price of rubber. Yet there were certain facts that seemed to contradict these opinions. Well over half the world demand for crude rubber came from the United States, whose direct contribution to the rearmament race was but a small one. The greatest single cause of the rising price of rubber was the prosperity of American civil industry, particularly the manufacture of motor-cars. Nor was there any clear sign that European countries were in fact accumulating big stocks of rubber for strategic or other reasons during 1936. On the contrary, the same professional review of the market referred to the depletion of Continental stocks almost to starvation point. On the whole, it is safe to conclude that rearmament played only a minor role in causing the rise of rubber prices in 1936.

Indeed, the effect of heightened international tension was not all on that side of the scales. The more imminent the danger of a war in which economic pressure might be decisive, the greater became the anxiety of importing countries who possessed neither colonies nor the command of the seas to cut down their needs of rubber by curtailing civilian demand and by using substitutes. In February 1935 Herr Hitler, when opening the German motor exhibition, referred to the fact that I.G. Farbenindustrie had invented, and had been developing at considerable cost since 1926, a rubber substitute called Buna, which, the company claimed, was in some respects better than rubber, having greater resistance to age, to temperature, and to wear and tear. But although the costs of production of Buna had never been revealed, it was generally supposed that they were at least double those of importing natural rubber. The cost of an American form of synthetic rubber, first produced in 1934 by the Dupont Chemical Company and the Dayton Rubber Manufacturing Company, had been stated to be about $1 a pound. In November 1936, however, a delegation of American manufacturers, visiting London in order to urge on the International Rubber

Committee the need for maintaining a reasonably low price, remarked in an interview that synthetic rubber was already a significant factor in the market and would, in time, become a serious menace to the plantation industry. Early in 1937 important new steps were taken by the German Government to stimulate the production of synthetic rubber.[1] The use of reclaimed rubber was also stimulated, as it had been during earlier rubber booms. In January 1936 the proportion of reclaimed rubber in the American consumption figures was 20·7 per cent.; a year later it had risen to 27·4 per cent.

Tin.

The international tin restriction scheme, like others of its kind, had been faced with two continuous dangers—the competition of areas outside the scheme, and the possibility of a deflection of demand to substitutes. The non-restricting countries had little to gain by adherence, since they secured the advantage of higher prices without the penalty of limiting their production. They could be induced to join only on the condition that their exportable allowances represented in fact no restriction at all. On the 10th July 1934 the International Tin Committee had published the terms on which French Indo-China, the Belgian Congo and Ruanda-Urundi, Portugal, and Cornwall would participate in the scheme. Each area was granted a minimum exportable allowance substantially above its actual production in 1933. Moreover, if the degree of quota restriction should fall below 35 per cent. of standard tonnages, these allowances were to be increased. The following table shows the terms in detail:

	Actual production		*Minimum export quota*		
	1929 tons	*1933 tons*	*1934 tons*	*1935 tons*	*1936 tons*
French Indo-China . .	829	1,055	1,700	2,500	3,000
Belgian Congo . . .	1,411	2,916	4,500	6,000	7,000
Portugal	390*	550	650	650	650
Cornwall . . .	513*	1,369	1,700	1,700	1,700
Totals . . .		5,890	8,550	10,850	12,350

* In 1931.

[1] See below, p. 471.

Both the threat of encroachment by non-restricting areas and the threat of a diversion of demand to alternative products obviously increased with every rise in the price of tin. It was reported in 1934 that in the United States, the principal consuming country, aluminium and lead were being increasingly used instead of tin in the manufacture of such products as foil, pipes, collapsible tubes, and solder, and that titanium oxide was being substituted for tin oxide. For some industrial purposes copper was also being used as a substitute for tin, but the rapid increase in copper prices in 1935 soon checked this trend, and the general acceleration of industrial activity, especially in the armaments, automobile, and tin-plate industries, fully made up for any transfer of demand to alternative products. At the end of October 1934 it was announced that representatives of consuming interests in the United States and Great Britain were to be invited to sit on the International Tin Committee, in a consultative capacity only. Agitation nevertheless continued to be raised in the United States, and among metal market and consuming interests in Great Britain, against the operation of restriction.

The international scheme, unless renewed by agreement, was due to end on the 31st December 1936. Already at the end of 1935 discussions were proceeding with regard to its prolongation and amendment. In May 1936 the International Tin Committee stated that the four signatory countries—Bolivia, Malaya, the Netherlands East Indies, and Nigeria—were willing to continue 'control' for a further period, on a basis to which they all agreed, provided that Siam, the Belgian Congo, and other tin-producing countries participated on satisfactory terms. Siam and the Belgian Congo, however, were claiming substantial increases in their standard tonnages. Negotiations with Belgian representatives had reached a satisfactory point, and a delegation was being sent to Bangkok to negotiate with the Siamese Government.

The position was complicated by the fact that Japanese interests were negotiating with Siam with the aim of establishing closer economic relations between the two countries, especially in the tin industry; a proposal was being put forward for the erection of tin-smelting plant in Siam under the control

of Japanese capital. Moreover, the Malayan producers, who had all along been on the side of moderation in restriction, were in no mood to grant large concessions. Apart from the encroachment of non-restricting countries, their fundamental grievance lay in the fact that their costs of production were lower than those in almost any other producing area, and that they were being obliged to curtail their output in order to maintain the high prices that alone would afford profits in Bolivia and the Netherlands East Indies (so long as the guilder kept its parity with gold). A price of £175 a ton, which would hardly pay expenses in Bolivia, would afford most Malayan producers a substantial profit.

Hopes of a settlement were raised by the announcement on the 6th July 1936 that Bolivia would surrender her right to produce the arrears of permissible tonnage that she had failed to export. Bolivia's quota would be reduced to 75 per cent. (instead of 90 per cent., the rate then in force), and on paper the same percentage would be applied to the other signatories of the pact. But Bolivia's accumulated arrears, amounting to 10,288 tons, would be distributed among them in such a way as to restore the actual allowances for Malaya, the Netherlands East Indies, and Nigeria to 90 per cent. of standard tonnages. The chief importance of the adjustment lay in the greater opportunity that it gave for the three restricting countries to make an offer to Siam that would not involve curtailing their standard tonnages.

On the 27th July, however, it was officially announced that the negotiations with Siam had broken down. Her representatives were demanding a basic allowance of 18,000 to 20,000 tons per annum, whereas the Committee, it was reported, refused to offer more than 15,000 tons. The Siamese spokesmen claimed that Siam was capable of producing 25,000 tons per annum if restriction were abandoned. Negotiations were, however, resumed, and in November an agreement was reached, subject to approval by the Governments concerned. Their ratifications having been completed, details of the agreement were published on the 7th January 1937. The standard tonnages for Malaya, Bolivia, the Netherlands East Indies, Nigeria, and French Indo-China were unchanged.

Siam was allotted a standard of 18,500 tons, whereas with an international quota of 100 per cent. her permissible output under the old sliding-scale plan would have been 13,500 tons. On a similar basis of comparison, the allowance for the Belgian Congo was raised from about 8,000 tons to 15,200 tons. The general effect of the new tin scheme was summed up in the accompanying reduction of the international quota from 105 per cent., at which it had been fixed for the last quarter of 1936, to 100 per cent. for the first quarter of 1937; for this limitation had full effect upon the output of the countries whose basic allowances remained unchanged, while leaving the total world output at its former level.

The agreement was to have a life of five years, but there was an 'escape' clause for the benefit of any participating territory that might become engaged in war. A further clause allowed notice of withdrawal to be given if production outside the seven signatory countries exceeded, over a period of six consecutive months, 12,500 tons, or 15 per cent. of estimated world output. At the time when the agreement was signed 'outside' countries were producing about 20,000 tons of tin per annum.

Important changes were made in the rules for voting on quota decisions and other issues. The unanimity rule was abandoned, and the votes were allotted in such a way that a combination of Malaya, Nigeria, and the Netherlands East Indies would always have a majority. This group, being low-cost producers able to fill their whole allowances, had a prime interest in maintaining output and consumption at the highest possible level. The Netherlands East Indies, formerly a comparatively high-cost area, had been brought into step with Malaya through a great economy of productive costs and through the devaluation of the guilder.

The quota for the second quarter of 1937 was maintained at 100 per cent. of standard tonnages. In making this announcement, the Committee stated that the outcome was expected to be an addition of about 1,600 tons a month to stocks, on the hypothesis that world consumption would be maintained at 170,000 tons per annum. But consumption was apparently running well above that figure, and this was one reason for a

swift boom in tin that developed in March 1937, bringing the price of spot tin in London above £300 a ton. A fortnight earlier it had been no higher than £256. Immediately before the agreement had been reached with Siam, spot tin had sold for only £215. The causes of this rise in prices were complex. In its later phase an element of pure speculation was undoubtedly important; and for the greater part of 1936 the market had been depressed by the fear of a complete breakdown of international control. But neither bull speculation nor the sharp reaction from abnormal depression would have occurred but for the increase in world demand. The apparent consumption of tin in 1936 was 157,182 tons, an increase of 10·3 per cent. on the previous year. Eight-ninths of this increase in consumption was in the United States. Three-fifths of it was for the making of tin-plates, used mainly in canning foodstuffs. These proportions do not suggest that European armament manufacture had any close connexion with the rising price of tin in 1936, though the accumulation of preserved food against the contingency of war may have had a certain effect. Moreover, although rearmament continued unabated, by May the London price of tin had fallen once more below £250 a ton.

Copper.

In many ways the market careers of tin and copper were closely allied, but their experience in regard to restriction was quite dissimilar. The copper restriction agreement, which was the last of the great international schemes for restricting the supply of raw commodities to be put into operation, was the first to be suspended; meanwhile the degree of restriction had been steadily whittled away, as prices rose higher and higher. The initial rate of curtailment of production, operative from the 1st June 1935, was 30 per cent. From the 1st August 1936 it was reduced to 25 per cent., and two months later to 20 per cent. By the 5th November it had become negative, the authorized allowance having been raised by three rapid degrees to 105 per cent. of the standard tonnages.

These standard tonnages had never been officially

announced, but were understood to total about 600,000 tons, whereas the maximum productive capacity of the three countries concerned—Chile, Northern Rhodesia, and the Belgian Congo—was in the neighbourhood of a million tons. Hence a 105 per cent. quota still represented a considerable measure of restriction by comparison with productive capacity. On the 13th January 1937 it was announced that all restriction on production would be temporarily removed, the adherents to the scheme having unanimously agreed on the conditions under which curtailment was again to become effective if necessary.

For the time being, the price was a dream of avarice for low-cost copper producers. When the restriction agreement was reached in March 1935 standard copper sold in London for about £30 a ton. At the height of the 'commodity boom', in the first three months of 1937, it touched £73 10*s*. a ton. This was about three and a half times the operating costs of the Northern Rhodesian copper-mining companies. The proximate cause of the rise in prices in 1936 was the decline in world stocks of copper, as a result of the restriction agreement and the acceleration of consumers' purchases. According to the British South Africa Company, the actual consumption of copper outside the United States fell slightly in 1936, from 1,103,000 tons to 1,100,000 tons, but output simultaneously fell from 1,110,000 tons to 1,060,000 tons.

These figures did not suggest that armament needs were a major stimulant of higher prices. The requirement of copper for munitions was perhaps exaggerated in the minds of some speculators. A programme of ten new 10,000-ton cruisers, for example, would need only 2,000 tons of copper, of which possibly half would be derived from scrap. And 1,000 tons of copper was less than one-tenth of 1 per cent. of annual world requirements of new copper. An analysis of copper consumption in the United States in 1935 showed that 23 per cent. went into electrical manufactures, 11 per cent. into the telephone and telegraph industry and light and power cables, 8 per cent. into wire cloth and other forms of rod and wire, 15 per cent. into motor-cars, 8 per cent. into the building industry, 7 per cent. into domestic appliances, 6 per cent. into metal castings,

and only 2 per cent. into ammunition of all kinds, the remaining 18 per cent. being divided among a variety of minor uses. The housing boom (with the associated inflation of demand for telephones, electrical equipment, household appliances, and other copper-containing articles) was much more important than the armaments boom in bringing about the rise of copper prices in 1936, or rather in helping the restriction scheme to bring it about. In spite of armaments, Germany's consumption of copper was 10 per cent. lower in 1935 than it had been in 1925; whereas Great Britain's consumption was nearly twice as high, although in 1935 her rearmament programme had scarcely begun.

Oil.

Of all the chief raw materials (other than foodstuffs), oil entered most directly into final consumption. There was no such thing as a retail price of tin, for instance, but the retail price of oil was perhaps the best single index of the condition of the whole integrated oil-producing and oil-distributing industry. At the end of April 1937 the retail price of motor spirit was raised almost simultaneously in the British Isles, the United States, and a number of other large consuming countries, including France, Czechoslovakia, the Netherlands, Belgium, and Scandinavian countries. Excluding 8*d.* excise duty, the new British price was 11½*d.* a gallon, to which net figure it had been raised from 9*d.* by small stages spread over twelve months. The lowest ex-duty price during the depression had been 8½*d.*, which ruled from July 1931 until September 1932. From March to November 1929 the ex-duty price had been 1*s.* 3*d.* a gallon.

The consumption and production of petroleum and related fuels were higher in 1936 than ever before. World output was estimated at 1,847 million barrels, and consumption at 1,760 million barrels, but higher prices were encouraged by the fact that consumption was rising faster than production. The 'hot oil' trouble in the United States had been successfully brought under control by state legislation backed by Federal prohibition of inter-state shipments in excess of amounts permitted under the state laws. Exports of oil from the U.S.S.R. were

declining, having totalled only 2,650,800 tons in 1936, compared with a record figure of 6,101,900 tons in 1932. Rumanian output also appeared to be on the down-grade, and Iranian output to be stabilized. Venezuela and Mexico had suffered from industrial and political disturbances. The main new source of oil was Bahrayn. The output of this area rose from 700,000 barrels in the first quarter of 1936 to 2,080,000 barrels in the first quarter of 1937. So long, however, as consumption continued to rise, this addition to supplies could be absorbed without any depression of prices.

It is not easy to assess the part that military or semi-military demand played in causing the rise in prices. Save in actual warfare, even highly mechanized armies and oil-burning navies required only a very small fraction of the oil consumed by commercial and private users. While the consumption of oil in the United States rose by 10 per cent. between 1935 and 1936, it rose by only 8·7 per cent. outside the United States; the latter country absorbed very nearly two-thirds of the total natural mineral oil produced in the world. The accumulation of stocks for strategic purposes was offset by the efforts of several countries to render themselves less dependent on foreign sources of oil, either by developing substitutes or by exploiting oil-fields under their political control with little regard to competitive cost. Since 1933 Germany had provided about half her requirements of oil from domestic sources, chiefly by the hydrogenation of coal or lignite. German experts claimed, furthermore, that before long synthetic oil would be able to compete in price with the natural product. It was announced in March 1937 that the Japanese Government would spend 95 million yen (about £5,250,000), spread over seven years, in subsidizing the production of synthetic oil.

Tea.

The story of the international trade in tea affords an interesting and important contrast with that of industrial raw materials over the same period. The doubling of the price of tin made little difference to the retail price of the motor-cars in which it was incorporated; but the doubling of the

wholesale price of tea would have meant virtually the doubling of the retail price of tea, with dire effect upon the volume of demand. The comparison with industrial products is all the more direct in that tea, like tin and other raw materials, was the object of an international restriction scheme.

For 1935–6 and 1936–7 (years beginning in April), export quotas were fixed at 82½ per cent., and in November 1936 it was decided to retain the same allowance for a further year. In the following May, however, the International Tea Committee surprised the market by raising the quota to 87½ per cent. for the whole of the fifth and last year of the scheme, which was due to terminate, unless renewed, at the end of March 1938. The change of policy was suggested by rising prices and rapidly falling stocks of the cheaper teas. Common Indian teas were then selling at round about 1*s.* 3*d.* a pound, compared with an average of about 1*s.* a pound over the whole of 1936. This advance of prices, though holding out the menace of a decline in consumption, was itself the result of a rapid increase of consumption. Prices fell by about 1*d.* a pound after the announcement of the enlargement of the quota, but the state of the market in early 1937 suggested an increase of about 30 per cent. in total purchasing power for tea in the course of a year, after taking into account both higher prices and larger absorption.

Sugar.

The price of sugar was exceptionally slow in rising from its depression trough; indeed it fell almost continuously until the last few months of 1936, despite the fact that consumption had for some years been ahead of production. From 1928 to 1935 the annual average price (centrifugals, 96 degrees, c.i.f. United Kingdom) fell from 11*s.* 7½*d.* per cwt. to 4*s.* 8*d.* per cwt., and the average for 1936 was less than a penny per cwt. higher than in 1935. Yet by the end of January 1937 the price was well over 6*s.* per cwt., having risen by 20 per cent. in a month.

The cause of this sudden advance was partly the rise in the level of demand in relation to output, but more particularly the anticipation of a new international restriction scheme, rid

of the fatal weakness of the Chadbourne Plan in omitting certain producing areas that could steal a march on their restricting competitors. In form, the World Sugar Conference that assembled, in April 1937, in London was a by-product of the World Economic Conference of 1933. It struggled through many trials before it reached agreement early in May. Its fundamental difficulty was the fact that little more than one-tenth of the total market was available for international competition, the remainder being reserved for domestic or colonial producers. In consequence, for many countries the importance of the free market lay less in the profit or loss at which sugar could be sold there than in its ability to absorb at almost any price a relatively small exportable surplus.

A very large portion of the free world market was provided by the British Empire, whose undertakings therefore formed a critical part of the new scheme. The United Kingdom undertook to retain the existing limit of 560,000 tons per annum on the domestic production of sugar, and to stabilize imperial preferences at their existing rates. Quotas were fixed for the export of sugar from the British colonies, from Australia, and from South Africa; and India undertook not to export sugar by sea elsewhere than to Burma. The British colonial quota represented a reduction of about 5 per cent. on exports in 1936. It was agreed that, if consumption in the British Empire should increase, the additional imports would be divided between the Dominion and colonial exporters and the foreign exporters to the free market, in proportion to their existing shares of total Empire imports of sugar—that is to say, roughly in the ratio of 1 to 2. The quotas allotted for export to the free market in 1937–8 totalled 3,610,000 tons. The European countries, however, agreed not to use 126,500 tons of their quotas in 1937–8. It was further provided that the International Sugar Council set up under the scheme should have power to reduce all effective quotas by a maximum of 5 per cent. during the first two years of its currency. These reductions brought the total of minimum quotas down to approximately 3,310,000 tons for 1937–8, whereas the requirements of the free market in the 1936–7 season had been estimated at 3,170,000 metric tons.

Cocoa.

Cocoa seems remote from armaments, but it was typical of the speculative rise in commodity prices in late 1936 and early 1937 that the requirements of chocolate for military field-rations should have been seriously cited as a reason to justify higher prices for cocoa. The market for this innocuous commodity actually suffered as acute a speculative inflammation as any raw-material market. Prices for cocoa had been depressed by the persistent excess of production over consumption, but the gap had been greatly narrowed by 1935, and when it seemed likely that production would fall slightly in 1936, while consumption was still rising, prices began to move steadily upwards. The consumption of cocoa in 1936, estimated at 682,000 metric tons, was over three times as high as it had been in 1913. The price of Accra cocoa in London rose from £23 at the beginning to £52 at the end of the year, and approached £60 a few weeks later. Then came a sudden pricking of the bubble, and cocoa shared fully in the subsequent fall of commodity prices. The higher cost had already induced a tendency to economize in cocoa among chocolate manufacturers, notably in Germany.

Wool.

An important sidelight was thrown upon the general state of world trade in 1936 by the fact that an intense economic dispute between Australia and Japan, which lasted from May to December of that year, and which resulted in the complete withdrawal of Japanese buyers from the Australian wool sales, had only a temporary and minor effect upon the price of wool. Certainly the Japanese action did not so much diminish the demand for wool as divert it to South Africa, New Zealand, and other producing countries. But in less favourable economic times it would inevitably have caused a sharp depression of prices, at least in Australia, whereas in actual fact average prices of wool were considerably higher throughout 1936 than in the previous season (July to June). Australian sales of wool in 1935–6 fell from 3,040,421 bales to 2,816,912 bales, but the total price received rose from £38,526,000 to £49,619,000 (Australian currency). New Zealand, favoured

by the Japanese-Australian dispute, and having considerable stocks on hand from the 1934–5 season, sold 756,833 bales for £10,083,000 (New Zealand currency) instead of 479,797 bales for £4,486,000.

On the other side of the bargain, the shifts in the international demand for wool are shown in the following table:

Absorption[1] *of Wool in Principal Consuming Countries*

(In millions of pounds)

Year	*U.K.*	*U.S.A.*	*France*	*Germany*	*U.S.S.R.*	*Italy*	*Japan*
1929	556	672	606	382	480	164	107
1934	604	559	388	351	196	183	182
1935	644	653	441	319	234	156	244
1936	711	702	390	283	298	83 (est.)	217

The comparison between 1934 and 1936 is almost as significant as the changes since 1929. The larger absorption in France and the U.S.S.R., the two countries that had been mainly responsible for the reduced total demand up to 1934, contrasted with fresh declines in imports into Germany and Italy. Meanwhile, the exceptional prosperity of the English wool-manufacturing industry, and the rapid recovery of American manufacture, made the chief contribution to increased world demand. This suggested that in spite of the need for wool for military clothing the rearmament boom was of secondary importance in the world wool trade. Indeed the net effect of military nationalism may even have been the opposite, on account of the stimulus given to the production of synthetic substitutes. The output of staple fibre (a wool substitute akin to rayon), which was negligible before 1930, rose to 259,500,000 lb. in 1936.

Lead and Zinc.

Lead and zinc were among the few raw commodities to which no international restriction scheme applied in 1935 and 1936. There had, indeed, been an international cartel of zinc producers from August 1931 until the end of 1934 (with a brief lapse early in 1933) but the agreement was not renewed

[1] Net imports *plus* home production. *Source*: Imperial Economic Committee.

upon its expiry. There were certain fundamental obstacles in the way of the international restriction of zinc production. In the first place, zinc was very largely produced in conjunction with other metals, often as a by-product only. Secondly, roughly one-third to two-fifths of the world zinc output was refined by customs smelters, whose interest lay in a large turnover rather than in high prices for the concentrates, and who feared that a reduced world output of ore would mean that a still higher share of the smelting would go to the countries of origin. Thirdly, even those countries that possessed few or no resources of zinc-bearing ore of their own were engaged in protecting or subsidizing national smelting industries as a strategic as well as an economic insurance. In September 1934 the subsidies paid by the Reich Government to the German spelter industry were considerably enlarged. Other European countries that gave national protection or subsidy to zinc-smelting included Italy, France, and Czechoslovakia. In the United Kingdom, the smelting industry was a direct product of the War of 1914–18, and it was officially designated a key industry according to the test of necessity for national safety, having regard to the strategic importance of supplies, not only of zinc, but also of sulphuric acid, the chief by-product of zinc-smelting. The smelters' claims for protection became the more insistent as other industries, less vital in this strategic sense, were granted protective tariffs after 1931. On the other hand, practically all the necessary ore and concentrates would have to be imported in any case, and the smelting capacity within the British Empire was already sufficient to meet the Empire's own internal needs.

In spite of all these difficulties, it was widely expected that the negotiations for a revival of the International Zinc Cartel, which were opened at the end of 1935, would reach a successful conclusion, but in August 1936 they were finally broken off. Later in the year, however, after a slump in prices caused by this event, the general influences that drove up the prices of other metals had their way with zinc also. From £13 10*s.* a ton at the end of August, the price of spelter on the London Metal Exchange rose above £20 in December, a mark that had not been reached since 1930. At the peak of the commodity

boom in March 1937 it touched £37. By the 7th April it was down again to £26 a ton. Apart from purely speculative influences, the increase of prices was based on the hope of rapidly rising industrial demand, especially in the United States. Rearmament undoubtedly played a part in the demand for zinc, but the balance of influence may actually have been on the other side, as a result of the strategically inspired protection of national smelting industries.

Since lead and zinc were largely produced from the same bodies of ore, their fortunes in the market were also closely allied. In the earlier phase of recovery, there had been a distinct contrast between the excess of zinc produced over the world demand for it, and the excess of consumption of lead over the world supply. The more favoured position of lead was not due to organized restriction. At the beginning of the World Depression a lead pool had tried, with little success, to minimize the fluctuation of prices, but it was dissolved in March 1932. Not until July 1935 did the world's lead producers come together, to agree merely not to increase production without due notice. Smelter production of lead outside the United States (which constituted a separate and almost an isolated market) rose from 903,600 metric tons in 1933 to 1,078,800 metric tons in 1935. Meanwhile, the low prices at which lead could be obtained had greatly stimulated its consumption. Consumption outside the United States rose from 918,000 metric tons in 1933 to 1,099,100 metric tons in 1935. The 1935 consumption figure was over 5 per cent. above the 1929 level, the previous high-water mark. This increase, however, was almost entirely concentrated in the United Kingdom. In the United States, output and consumption in 1935 were alike running at about half their pre-depression volumes.

In 1936, both consumption and production of lead continued to expand. During the second half of the year, a new factor affected the market—the disturbance of Spanish supplies by the civil war. This was of much less moment, however, than it would have been at earlier periods. Until 1897, Spain had been the chief lead-producing country in the world, but after the War of 1914–18 her position in this respect gradually

declined. During the first six months of 1936 she produced only 28,070 tons, of which some 40 per cent. was required for domestic industry. It was not this accidental curtailment of output in one area (which was at least balanced by new productive capacity elsewhere, notably in Australia, Canada, Newfoundland, Yugoslavia, and the U.S.S.R.) but the general increase of world demand that drove up the price of lead in 1936 and early 1937. At the peak of the speculative boom in March 1937, the quotation for lead on the London Metal Exchange was £36 7*s.* 6*d.* per ton, and although it fell to £25 13*s.* 9*d.* on the 7th April even this figure was nearly 60 per cent. higher than the price twelve months earlier.

Undoubtedly armament demand played a part in increasing the consumption of lead. Nevertheless, there were plenty of signs that other influences were much more important. The increase of the consumption of lead outside the United States from 1933 to 1935, when rearmament was still in its earlier phases, has already been noted; many new uses—peaceful uses—for lead had been found under the stimulus of low prices. Again, consumption of lead in Great Britain, so far from increasing rapidly in 1936, remained at almost the same level as in 1935.

Nickel.

No less than four-fifths of the total production of nickel was controlled by the International Nickel Company of Canada, whose policy it was, not to rack consumers through the exploitation of this monopoly power, but to maintain steady prices for nickel and platinum at levels low enough to stimulate consumption.[1] Largely, no doubt, as a result of this policy, it sold in 1936 more nickel, copper, and platinum metals than in any previous year. The fact that nickel was essential to the manufacture of modern armaments, notably as an ingredient in armour-plating steel alloys, prompted a popular belief that the prosperity of the nickel industry was due mainly or largely to rearmament. This view was trenchantly rejected by the chairman of the International Nickel Company. In his address

[1] In 1936 the price of nickel in the United States and Canada remained unchanged at a level that had been continuously maintained for a decade.

to the annual meeting of shareholders in March 1937, he pointed out that 54 per cent. of the company's sales of nickel were in the United States and Canada, and that consumption in those countries increased by 35 per cent. over the preceding year, whereas consumption elsewhere increased by 25 per cent.

'These figures [he continued] are significant in that they refute the suggestion, sometimes made, that the prosperity and development of your company are based upon military expenditures. The greatest increase of consumption, as well as the largest market, has been in two countries which have abstained from any large rearmament programme.'

(b) *Armaments and Self-sufficiency*

Different as were the experiences of the various commodity markets, one or two main threads show through the tangled story. In the first place, there was, by the beginning of 1937, a general wilting of the practical influence of restriction. New schemes, it is true, had been introduced and old ones technically strengthened, but four of the most outstanding international schemes in the whole list—those for wheat, rubber, tin, and copper—had either openly or tacitly ceased to be restrictive. It was common form for an announcement of an increase in permissible quotas under a restriction scheme to be followed by a rise rather than a fall in prices.

In the second place, the armament demand was undoubtedly given a high place in the speculators' judgement of the influences affecting commodity markets. Even the diamond market was reported to be helped by the demand for industrial diamonds in the manufacture of armaments. Wool for uniforms, cocoa for field-rations, oil for tanks and warships, as well as base metals and steel alloys for actual munitions, were all mentioned in market gossip as important influences on the course of prices. In the third place, there is equally little doubt that these suppositions were exaggerated. For no commodity in the selection reviewed above did it appear, on a close examination of the facts, that expenditure on armaments was by itself a decisive direct cause of the rise in prices. It must not be left out of account, however, that when production and consumption were narrowly adjusted to each other a

comparatively small increase in demand might have a disproportionate effect upon prices; and this might perhaps have lent special moment to the military absorption of certain commodities.

To some extent, moreover, purchases for armament purposes may have been masked, either in order to avoid a speculative increase of prices against the purchaser, or for political reasons. Thus Sir Thomas Inskip, Minister for the Co-ordination of Defence in the United Kingdom Government, stated in June 1937 that vast stores of oil had been accumulated for the Navy, that decisions had been taken to provide or store up some of the most important of the raw materials required by industry in war-time, and that considerable supplies of some of these materials were already available for any emergency. Yet, even with every allowance for hidden purchases, the evidence cannot be said to show any clear direct connexion between rearmament and the rise in prices. The group of commodities most directly affected by armament demand was undoubtedly that of the metals used for special steel alloys essential to the manufacture of guns, munitions, and armour plating. Yet nickel and molybdenum were unchanged in price, and wolfram and antimony were among the very few commodities whose price actually fell during 1936 (respectively from 35*s.* 6*d.* to 33*s.* per unit, and from £66 10*s.* to £60 per ton).

Furthermore, the apprehension of possible war gave rise to an adverse secondary influence upon international prices—the efforts towards greater national self-sufficiency, through the exploitation of local resources, even at very high cost, and through the development of synthetic substitutes for natural products.

The German Government, in particular, continued to lay the greatest stress upon their self-sufficiency policy as a strategic insurance. On the 9th September 1936 Herr Hitler issued a proclamation to the National-Socialist Party rally at Nuremberg, in the course of which he said:

'Within four years Germany shall be independent of all foreign countries in respect to all those materials which she can produce at home by means of German ingenuity and our mining, engineering, and chemical industries. When the process of rearmament is completed the labour now employed therein will

be diverted into productive channels through the development of the great new German raw material industries. We hope that in this way production will be stimulated in many spheres so that we can devote our export surplus to purchases of food and indispensable raw materials.'

The execution of the Four-Year Plan, which was committed to the charge of General Göring, officially began in February 1937. On the 21st February the Führer returned to the theme in a speech at the opening of the Berlin Motor Exhibition.

'Germany must be made independent of the raw materials necessary for the new cars—not only the fuel, but also the materials for the parts. We shall succeed in this as we have done in other things. . . . We have succeeded in making benzine from coal, and synthetic rubber, and we have plenty of iron-ore in our country. We also have enough coal.

'We must make the motor-car industry completely independent of foreign imports. Either German industry as a whole is capable of solving these problems, or it is not capable of existing as an independent organization. Naturally, however, we shall not cease to foster our foreign trade relations.'

A great deal of importance lay in the last sentence. For, in spite of more than two years of strict official control of imports, Germany had not succeeded in substantially reducing her dependence on foreign sources of supply of foodstuffs and raw materials. In 1936, of her Rm.4,220 millions of imports, 35·5 per cent. consisted of foods and animal fodder, 37·3 per cent. of raw materials, 17·8 per cent. of semi-finished products, and only 9·4 per cent. of finished products. Neither the absolute amounts nor the proportions had changed much between 1935 and 1936. It was, in fact, only in regard to grains and textiles that Germany's devotion to *autarkeia* appeared to have had any striking measure of success in reducing imported supplies, and even here the result of a bad crop in 1935, followed by another in 1936, was that she became again a very heavy importer of bread grain in 1937. In regard to textile raw materials the achievement was of a more durable kind. Between 1933 and 1936, imports of cotton were reduced from 417,000 to 237,000 tons, and of wool from 136,000 to less than 85,000 tons (greasy). In the same interval, the domestic

output of wool rose from 5,000 to 6,000 tons, and of flax and hemp from 3,000 to 40,000 tons. The fibre-material content of rags reclaimed—roughly 45,000 tons in 1933—was trebled. The production of rayon and staple fibre rose from 33,000 tons in 1933 to about 100,000 tons in 1936. Scarcely any textile materials were being woven in Germany without an admixture either of reclaimed or of synthetic fibres. Nevertheless, part of the 1936 economy of imports had to be achieved through a reduction of stocks, amounting to between 5 and 10 per cent. of the total requirements of the German textile industry.

Of the foodstuffs other than grain, coffee showed an increase of imports from 130,000 tons in 1933 to 155,000 tons in 1936. There were, on the other hand, small reductions in imports of cocoa and tea, while an import surplus of 10,000 tons of sugar became an export surplus of nearly 4,000 tons. In the group of metals a large economy in the money-cost of imports was achieved through a systematic diversion of purchases towards raw supplies at the lowest stages of production. Thus, while imports of refined zinc fell sharply, between 1933 and 1936, from 46,000 to 14,000 tons, and imports of raw zinc rose only from 55,000 to 59,000 tons, an export surplus of 22,000 tons of zinc ore became an import surplus of 102,000 tons, thanks to the smelting of the Silesian output in German instead of Polish refineries. Similarly, while imports of metallic copper rose only from 120,000 to 124,000 tons, imports of copper ore rose from 230,000 to 477,000 tons. Imports of metallic tin were reduced from 11,000 to 8,000 tons, but imports of tin ore rose from 400 to over 1,500 tons. Equally significant were the greatly increased imports of bauxite, which rose from 239,000 to 981,000 tons; for the National-Socialist Government used every means to promote the replacement of other metals by aluminium (which could be produced with German capital and labour from raw material that was accountable for less than 10 per cent. of the total cost of production). Lead formed a notable exception to the rule of an increased proportion of ore to refined metal in Germany's purchases, the reason ascribed being the scarcity of available supplies of ore, as a result of the mining companies' policy of refining ore themselves or of entering into long-term contracts with refiners.

In the group of raw materials most closely associated with armaments—ferrous metals and the constituents of special steel alloys—there was as yet no sign of success in the achievement of self-sufficiency. Imports of iron ore rose from 4,572,000 to 18,469,000 tons between 1933 and 1936, of chrome ore from 48,000 to 123,000 tons, and of nickel, tungsten ore, and other steel-alloy metals from 16,000 to 46,000 tons. It was announced in July 1937 that a new company, the Reichswerke A.G. für Erzbergbau und Eisenhütten 'Hermann Göring', had been formed for the development, within the framework of the Four-Year Plan, of the recovery of iron from German ores. The iron ores of South Germany, though extensive, had been almost entirely neglected by private enterprise, owing to their low metallic content.

The last group of commodities to be considered in relation to the task of the Four-Year Plan is the group associated with the motor industry—oil and rubber. Imports of crude oil and petrol rose between 1933 and 1936 from 1,278,000 to 1,860,000 tons, of gas oil from 456,000 to 1,068,000 tons, and of rubber from 55,000 to 73,000 tons. In May 1937 an import duty of Rm.125 per 100 kilograms, equivalent to more than 100 per cent. *ad valorem*, was imposed on all rubber and guttapercha, which had previously entered duty free. Its proceeds were to be devoted entirely to the building of more works for the manufacture of 'Buna' (synthetic rubber). As for oil, the search for oil supplies in Germany was subsidized, but the chief effort was directed to the production of oil from coal. In the January and February of 1937 loans totalling Rm.122 millions were raised from the German market to finance the construction of hydrogenation plants.

This survey has suggested that the direct and immediate effect both of buying for armaments and of attempts at self-sufficiency upon the general commodity price-level could easily be exaggerated. How far was armament expansion indirectly responsible (through the well-understood inflationary process of Budget deficits or requisitioning of credits) for the general acceleration of industry and the enlargement of purchasing power all round? There can be no answer for the world as a whole; for both the date of the armament expansion

and its incidence upon the national economy varied enormously from country to country. The inflationary effect of a modern armament programme necessarily followed a rather different curve from the actual volume of governmental arms expenditure. Heavy capital outlay might have to be incurred by private industry well in advance of Government payments, which would in fact help to amortize expenditure already completed. In the case of a 'shadow factory' (constructed for the contingent, not actual, manufacture of military supplies), the rise and dip of the curve of augmented public purchasing power would display an even sharper contrast to the plateau-like graph of Exchequer outlay.

On the assumption that the influence of armament expansion on trade revival in any country reached its peak sooner and more suddenly than the armament expenditure itself, an inflationary zenith would have been attained in Germany about the middle of 1935, and in Great Britain at the end of 1936 or in the earlier months of 1937. A useful indication of the place of rearmament in trade revival may therefore be given by a comparison between the German and British indices of industrial production for those years.

Quarterly Indices of Industrial Production[1]

(1929 = 100)

	1934	*1935*			
	Average	*I*	*II*	*III*	*IV*
Germany	79·8	85·9[2]	93·6	97·1	98·8
United Kingdom	97·8	104·1	102·8	102·1	111·2

	1936				*1937*
	I	*II*	*III*	*IV*	*I*
Germany	94·3	106·6	110	112·8	108·1
United Kingdom	113·4	113·2	112·2	121·8	121·6

Despite the much greater rapidity of the advance in Germany, in relation to 1929, the position attained in Germany at the

[1] Germany: Institut für Konjunkturforschung (excluding food, drink, and tobacco); United Kingdom: Board of Trade. [2] Excluding Saar Territory.

end of the period was still much inferior to the position in the United Kingdom. In each country, it may be noted, there were two big steps on the ladder of recovery in 1935 and 1936: the German index rose by 9 per cent. between the first and second quarters of 1935, and by 13 per cent. between the first and second quarters of 1936; the British index rose by 9 per cent. between the third and fourth quarters of 1935, and by 8½ per cent. between the third and fourth quarters of 1936. Thus in each country it was the smaller of the two steps that coincided with the date that has been assigned above on *a priori* grounds as the moment of most rapid expansion of trade activity through rearmament. This suggests that other forces besides rearmament were playing an important part in expanding purchasing power. In Great Britain, certainly, the housing boom preceded and exceeded the armament boom. Nevertheless, the fact that the *a priori* assumption as to dates of expansion appears to be borne out by the figures suggests that no error is made in ascribing to rearmament a considerable part of the stimulus to general industrial activity in Western countries, and therefore indirectly to higher prices for industrial raw materials.

The consequences of higher prices were, of course, different for different countries, according to their position as manufacturers or as primary producers, as creditors or as debtors. Three main groups may be distinguished: the countries, being almost exclusively international debtors, that exported the foodstuffs and raw materials whose prices had risen; the importing countries that were also creditors, with a capitalist stake in the first group; and the importing countries that had no such stake or were actually debtors to the rest of the world. These groups of countries may be described as the producers, the investor-consumers, and the debtor-consumers. The 'producers' found the value of their exports increasing, and, although the increased purchasing power of their populations automatically entailed higher imports, their credit balances of trade were enlarged. Those 'producers' whose external indebtedness took the form mainly of share-investment in their industries paid out much of the extra trade surplus in dividends; those whose debt was of the fixed-interest type were

able to build up reserves of foreign assets, to pay off debt, or to increase their visible and invisible imports.

Imports and Exports of Certain Countries by Value

(In millions)

Country	*Currency*	*1934*		*1935*		*1936*	
		Imp.	*Exp.*	*Imp.*	*Exp.*	*Imp.*	*Exp.*
Australia . .	£ Aus.	82·8	98·1	95·4	113·2	107·6	125·5
New Zealand .	£ N.Z.	30·8	46·8	35·8	46	43·6	56·3
India . .	Rs.	1,252	1,483	1,343	1,571	1,223	1,805
Argentina . .	paper pesos	1,109	1,438	1,165	1,569	1,117	1,645
Brazil . .	milreis	2,503	3,460	3,856	4,104	4,268	4,896
China . .	standard $	1,030	535	919	576	941	706

The 'creditor-consumer' countries were compensated for the higher prices that they had to pay for their imports by the better return on their external investments. The first of the countries in this group was the United Kingdom. Her debit balance of trade in merchandise and silver rose from £294 millions in 1934 to £347 millions in 1936. Net national shipping income and net income from overseas investments, however, were estimated to have risen by £50 millions between 1934 and 1936—almost an exact counter-balance to the £53 million increase in the debit balance of trade. At the same time there was an immense influx of short-term capital which was balanced by imports of gold. Similar general conditions held good in the United States, the second of the great creditor countries of the world, though here the position was complicated by the fact that the United States was a considerable exporter as well as importer of raw products. In semi-manufactured and fully manufactured goods she had an export balance of trade amounting to $563 millions in 1934, $529 millions in 1935, and $556 millions in 1936. In raw materials and foodstuffs (both raw and manufactured) she had an import balance of trade amounting to $80 millions in 1934, $324 millions in 1935, and $596 millions in 1936. Hence her net credit balance of merchandise trade was reduced from $483 millions in 1934 to $205 millions in 1935, and to nil in 1936.

Of the other 'creditor-consumers', France was in a special category in that the change in her monetary policy and the impact of her internal economic reforms had an effect upon her balance of trade out of proportion to general world influences. Nevertheless, the rise in her imports from 20,900 million francs in 1935 to 25,400 million francs in 1936 may be partly ascribed to the higher prices of raw commodities. Retained imports of the Netherlands rose from 936 million florins in 1935 to 1,017 million florins in 1936, while exports rose from 675 million to 746 million florins. In Belgium, imports rose from 17,100 million to 21,100 million francs between 1935 and 1936, while exports rose from 15,800 million to 19,700 million francs. Both these creditor countries, therefore, escaped any large increase in their debit balances of trade.

The course of Germany's external trade—Germany being the chief representative of the 'debtor-consumer' countries—was not precisely what might have been expected in the light of the facts that her necessary imports were costing her more per unit of volume, that her self-sufficiency plans had not yet reached a high level of success, and that her internal recovery was largely stimulated by non-productive outlay of state money.

Germany's External Trade, 1933–6

(In millions of Reichsmarks)

	1933	*1934*	*1935*	*1936*
Imports	4,204	4,451	4,159	4,218
Exports	4,871	4,167	4,270	4,768
Balance	667	−284	111	550

How was the rise in German exports achieved, in the face of higher costs of production unrelieved by the currency depreciation that had favoured the export trade of most of Germany's competitors? Part of the answer is to be found in conditions outside Germany; for an increased purchasing power both in primary producing and in industrial countries had their due effect on demand for German products, especially in such trades as electrical engineering. But the answer is completed

only by reference to the system of regimented supply and demand current under the National-Socialist Government.

'The foreign exchange situation brought about a scarcity of significant import raw materials. The scarcity was increased by the rising demand and led to an increase in the prices of import raw materials, far in advance of the world market development. This increase had to be prevented in the interest of the economic development as a whole. . . . Of course this price regulation soon required an extensive system of supervision, which controlled not only the prices of various turnovers of these commodities, but which also at the same time undertook the regulations of supply and demand. . . . Thus the rank of purpose of utilization is no longer determined by the price, but by the supervisory boards, which are directed in their decision by considerations of general economic policy. . . . The rank of utilization of industrial raw materials and products is in general as follows:

'First of all comes export: demands of industries engaged in export trade are considered the most urgent and will be satisfied first. Then come Government projects in which the Army and —since the autumn of 1936—the Four-Year Plan play the leading parts. Third come special *social* problems (as far as they are not contained in the second group); these problems include workers' and farmers' settlements. Not until after the requirements of these three groups are satisfied is utilization for purely private purposes considered.'[1]

A levy on industry provided funds for a direct subsidy to exports, and premiums were also forthcoming through the use of various kinds of 'blocked marks', which their holders were willing to dispose of at a discount. Some short-term creditors of Germany themselves undertook the manufacture and utilization or marketing abroad of German shipping or industrial products as the only means of realizing their assets in Germany.

(c) *Conclusion*

Before September 1936 the greatest contrast in world economics had been that between the countries that were able to hoist themselves out of the depression by means of expansionary internal policies, and those whose currency systems

[1] Weekly report of the Institut für Konjunkturforschung, No. 21/22, 2nd June 1937.

forced them into deflationary contraction. After the demise of the gold bloc, the outstanding contrast changed into that between the liberal and authoritarian economies. The former sought prosperity and stability in the operation of a capitalist system working freely within the limits set by modern social standards, and sought national economic defence in the traditional methods of tariffs and direct subsidies. The latter pursued both these objectives through the machinery of the totalitarian state—controlling exchanges, rationing imports, fixing prices (including rents and wages), limiting profits, dictating the direction of industrial expansion, and generally subordinating economic motives to the preconceived purposes of the state.

This was the fifth main phase of international economic development, on the short-term scale, since the depression smote the world in 1929. The first phase lasted until the financial crisis of 1931, which drove the pound from gold and shivered the external economic systems of many European states. In this period, prices fell rapidly and unemployment increased everywhere, but the old order of currency relations and trade policies endured, save in some of the primary producing countries which had felt the earliest and most violent impact of the slump. The next phase came to an end about the time of the American bank crisis. It was a period of international defaults, of standstills, of exchange control, a period in which the financially weaker countries began to stand out from the financially stronger; in which the sterling bloc formed itself and laid the first foundation of local recovery in depreciated exchanges and cheap money combined with public confidence; in which world prices still fell and most countries touched the depth of depression; in which attempts to find a solution for the problem of the slump along internationalist lines were doomed to failure because the basic conditions of achievement—especially national self-confidence—were missing.

The next phase was one of national efforts towards recovery, efforts which on the whole were successful despite the fact that world prices continued to be low even in depreciated currencies. Private adjustments and economies produced a new

capacity for profit-making and commercial expansion; public policies in the greater number of countries were liberated from their old fetters either by the relinquishment of the gold standard or by the adoption of totalitarian methods. While incipient recovery in Great Britain and the British Dominions was characteristic of the previous phase, in this phase the recovery of the United States and of Germany may be taken as contrasted but equally characteristic types. Only the countries of the gold bloc continued to feel the ever-tightening grasp of depression, though even here deflation might eventually have succeeded had the spirit of international co-operation been stronger in the world at large, or had not economic difficulties been enhanced by internal as well as external political troubles. It was only in part a matter of cause and effect that the next phase, the phase of rapidly rising prices and the growth of a boom, began at about the same moment as the gold bloc finally collapsed. If the abandonment of the old monetary parities had succeeded in bringing about a new equilibrium in the gold bloc, on which economic expansion could be as safely based as it was in the sterling bloc, no doubt a greater power for good in world economic affairs would have had to be ascribed to that event. In fact, it represented only the removal of one secondary check to a world economic recovery which was primarily based on other forces—commercial expansion and governmental spending in a few great industrial countries that had long since freed their economies from purely monetary limitations.

That phase closed when the boom in prices in early 1937 was pricked. With that incident the period covered by this book came to an end, and later events are beyond the focus of its lens. One piece of speculation about the future may, however, be in place, since it is based on historical appreciation of the previous seven or eight years. Associated with the curve of economics was a curve of political change, neither exactly parallel with it nor wholly representing cause or effect of the economic ups and downs, but linked to the economic curve by many important ties. If the cause be sought in economic affairs and the effect in political, then there would appear to be a considerable time-lag; for the degeneration of international

relations began, with the Manchurian invasion, some three years after the world depression had been first felt by primary producing countries, and it spread to Europe some three years after the chief countries of that continent had seriously felt the same calamity; furthermore, the political degeneration continued almost without relief during several years of economic recovery. Thus economic prosperity might still perhaps bring its eventual reward in political appeasement. Even this hopeful assumption, however, needed a grim proviso; unless the opportunity of recovery could be taken to build a more stable and pacific political order, sooner or later deep and universal depression might return, and in its train add more political troubles to those already existing. This warning gained force and precision from the fact that mass rearmament had immensely strengthened one of the more direct ties between the political and economic curves. The economic tale of 1930 to 1937 is not entirely a gloomy one, for it needed good qualities in men and in their system to struggle upwards so successfully from disaster; but their success could be but dust and ashes unless it was crowned by a return to peace and goodwill among the nations.

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